Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

ANN MARK,

Petitioner,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, NEW YORK STATE RETIREMENT FUND and NEW YORK CITY PENSION FUNDS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 11(a) of the Securities Act of 1933 (the "Securities Act") holds an issuer strictly liable for material misstatements or omissions in a registration statement. In contrast, Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") requires proof of scienter to sustain a fraud claim. The Private Securities Litigation Reform Act of 1995 (the "PSLRA") reinforced these principles and this distinction by demanding a heightened pleading requirement for allegations made pursuant to the Exchange Act, but not the Securities Act. Rule 23(e) of the Federal Rules of Civil Procedure requires that the interests of class members and class representatives must be aligned in order for a settlement of a class action to be "fair, adequate, and reasonable."

Accordingly, when a plan of allocation makes no distinction between some class members who have demonstrably stronger Section 11 *strict liability claims* and who are *immediately entitled to summary judgment* as compared to other class members who have only Section 10(b) *fraud claims that require proof of scienter, years of discovery, trial and the uncertainties of proportionate liability*, can such a plan be found fair, adequate, and reasonable under Rule 23, particularly when the plan resulted from lead plaintiffs with substantial and demonstrated conflicts of interest that caused specifically identifiable and measurable monetary damage to class members with Section 11 claims?

LIST OF PARTIES

In addition to the parties listed in the caption, the following additional parties are being served as respondents:

Joanne A. Aboff Family Trust, U/A Dated 2/11/92

Betty Duncan

Tere Throenle

Faye Schonbrunn

Ernst & Young

Cendant Corporation

HFS Defendants - James E. Buckman
Leonard S. Coleman
Christel DeHaan
Martin L. Edelman
Scott E. Forbes
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Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The district court's opinion and order (per Walls, D.J.) appointing lead plaintiff (Appendix ("Pet. App.") E, 264a through 286a) is published at 182 F.R.D. 144. The district court's subsequent opinion and order granting the opt-out plaintiffs' motion for partial summary judgment (Pet. App. D, 241a through 263a) are published at 109 F. Supp. 2d 225. The district court's subsequent opinion and orders approving the settlement plan (Pet. App. B, 153a through 236a) and plan of allocation (Pet. App. C, 237a through 240a) are published at 109 F. Supp. 2d 235. The court of appeals' opinion and orders (per Becker, C.J., joined by Sloviter and Ambro, JJ.) affirming in part, and vacating in part, and remanding the settlement plan (Pet. App. A, 1a through 152a) are published at 264 F.3d 201. The court of appeals' order denying *rehearing* and *rehearing en banc* (Pet. App. F, 287a) is not otherwise published.

STATEMENT OF JURISDICTION

The court of appeals entered its opinion on August 28, 2001, and denied rehearing and rehearing en banc on October 4, 2001. Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

RULE INVOLVED

Federal Rule of Civil Procedure 23.

STATEMENT OF THE CASE

This Petition affords the Court the opportunity to apply the teachings of *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591 (1997), and *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999) – concerning the primacy (especially against expedience) of unconflicted class representation and counsel in resolving complex class litigation – to securities class actions governed

by the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 77z-1; 15 U.S.C. § 78u-4. This case involves the $3.2 billion settlement of the Cendant securities class action litigation, the largest settlement of a securities class action in history (the "Settlement"). Petitioner is challenging the grossly inadequate plan of allocation (the "Plan") spawned by this Settlement. Like the underlying facts in this Court's landmark decision in *Amchem*, the Settlement resulted from a single group of plaintiffs who settled disparate and conflicting claims of all class members. The Plan allocates the settlement proceeds among class members on an equal pro rata basis, regardless of the nature or strength of the claims held by different types of class members. Specifically, the Plan improperly allocates settlement funds equally between *strict liability* claims that provide for *joint and several liability* under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k and *fraud claims that require proof of scienter* and are also subject to defenses based on *proportionate liability* under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b).[1] Contrary to *Amchem*, however, and instead of insisting on the same due process protections and principles of unconflicted representation of divergent interests and claims, and without citing a single authority, the Third Circuit[2] fully retreated from and disregarded the very same protections and principles that it had previously enunciated in *Amchem*, and affirmed the district court's approval of the Plan.

Even more than the substantial theoretical and legal differences between more easily provable and stronger Section 11 strict liability claims and the weaker and more difficult to

1. Although all class members had Section 10(b) fraud claims, a smaller subset of class members also had stronger Section 11 Claims that resulted from their acquisition of Cendant shares through the Merger described in greater detail below. Class members with only Section 10(b) Claims are referred to as Section 10(b) claimants. Class members with both Section 11 *and* Section 10(b) Claims are referred to as Section 11 claimants.

2. The Third Circuit decision below was authored by the same distinguished jurist who authored the *Amchem* decision that was affirmed by this Court.

prove Section 10(b) fraud claims, the factual record of this litigation demonstrates the gross disparity between these claims. For example, the closely-related Cendant PRIDES class action litigation involved legal and factual issues identical to the strict liability Section 11 Claims in the main Cendant action. The action was quickly settled for more than 100 cents on the dollar (even after the payment of attorney's fees) after the lead plaintiff moved for summary judgment on the Section 11 strict liability claims. And as the district court held in approving of the Cendant PRIDES settlement: "The class is completely made whole by such compensation." *In re Cendant Corp. PRIDES Litig.*, 51 F. Supp. 2d 537, 541 (D.N.J. 1999), *aff'd in part, rev'd in part*, 235 F.3d 176 (3d Cir. 2000), *cert. denied*, 122 S. Ct. 202 (2001). Furthermore, in the main Cendant securities class action, class members who opted out early in the proceedings, easily obtained summary judgment against Cendant on Section 11 liability and for the vast majority of their claimed Section 11 damages even as they were denied summary judgment on the Section 10(b) fraud claims with respect to both liability and damages.

In contrast, the original Settlement amount was calculated to return 37 cents per dollar to all class members regardless of the nature and strength of their underlying claims. Whether a class member had a Section 11 strict liability claim or only a Section 10(b) fraud claim made no difference. Petitioner is not objecting to a *de minimus*, theoretical or illusory conflict or misallocation of settlement damages. Lead Plaintiffs' conflict here manifested itself as a concrete misallocation of between hundreds of millions and one billion dollars to Section 10(b) Claims that should have gone to Section 11 Claims. It cannot be reasonably disputed that, as shown in greater detail below, the Section 11 claimants, had they been permitted counsel dedicated exclusively to their claims, would have immediately moved for, and, as in *Yeager v. Cendant Corp.*, Pet. App. 241a-263a, the action brought by the opt-out class members, would

have obtained summary judgment against Cendant on Section 11 liability and on the vast majority of damages.

The Third Circuit evaded the most critical issue of all. It never disputed that if the Section 11 claimants had separate representation from the beginning, they had a clear path to an immediate judgment for liability and for most of their damages on a motion for summary judgment, and in the context of a plan of allocation, a much greater right to a substantially greater portion of the settlement proceeds. Instead, as set forth in greater detail below, the prosecution of the strict liability Section 11 claims was intentionally *deferred* and compromised for the benefit of the 10(b) claimants in order to bolster the more difficult to prove Section 10(b) claims. This improper conduct, expressly admitted by Lead Plaintiffs (defined below) in the Cendant Settlement notice, and further approved of and licensed by the Third Circuit, is the antithesis of how class actions are required to comport with the structural due process requirements of Rule 23 and be prosecuted for the benefit of all class members.

1. ***Background and Nature of the Action.***

This is a consolidated federal securities class action initiated in April 1998 by the filing of numerous shareholder class actions against Cendant and other parties arising from Cendant's admission that its financial books and records materially overstated its revenues and earnings. *In re Cendant Corp. Litig.*, (Pet. App. E, 264a through 286a) (D.N.J. 1998).[3] The claims in

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3. Petitioner Ann Mark filed her own complaint entitled *Ann Mark v. E. Kirk Shelton, et al.*, 98 CV 2004 (WHW) (D.N.J.), on or about April 29, 1998. She brought claims only on behalf of HFS shareholders who exchanged their shares for CUC in connection with the merger that created Cendant. Although she also purchased Cendant shares in the open market, like Lead Plaintiffs, her loss on the open market purchases was significantly less than her loss on the HFS shares. More importantly, unlike Lead Plaintiffs, Ms. Mark never sought to represent simultaneously both former HFS shareholders and Cendant purchasers with Section 10(b) claims.

these actions, relevant to the instant petition, were brought pursuant to Section 11 of the Securities Act, a strict liability claim against the issuer, and Section 10(b) of the Exchange Act, a fraud claim requiring proof of scienter that is subject to various defenses. The Section 11 Claims arose from the merger in December 1997 of CUC International, Inc. ("CUC") and HFS Incorporated ("HFS") to form Cendant Corporation ("Cendant" or the "Company"), wherein the HFS shareholders exchanged their HFS shares for shares of CUC which became Cendant (the "Merger").

In connection with the Merger, CUC and HFS issued a Form S-4 registration statement which included a prospectus. The Section 11 Claims were predicated on misstatements and omissions regarding revenues and earnings contained in the registration statement issued in connection with the Merger. The Section 10(b) Claims arose from open market purchases of CUC shares prior to the Merger and the open market purchase of Cendant shares after the Merger. The Section 10(b) Claims were based on false and misleading statements that caused the market price of Cendant's securities to be artificially inflated, thereby causing members of the class to overpay for those securities during the class period. At the end of the class period, Cendant admitted that its financial records materially overstated its revenues and earnings, thereby causing the price of its securities to substantially decline. These class actions, brought on behalf of purchasers of different types of securities purchased at different times over the three-year class period, often involving disparate circumstances, were consolidated by the district court on or about May 29, 1998.

2. *Potential Intra-Class Conflicts and the District Court's Lead Plaintiff Decision.*

Fifteen motions were filed by individual plaintiffs or plaintiff groups for appointment as lead plaintiff pursuant to the PSLRA. Each movant also sought to have its chosen attorney appointed as lead counsel. The movants essentially fell into one or more of the following categories: (1) former holders of CUC

stock; (2) former holders of HFS stock; (3) purchasers of Cendant stock; and (4) purchasers of Feline Prides ("PRIDES").[4] Several movants expressed concern that the three lead plaintiffs eventually appointed by the district court "would be motivated to 'tilt' the litigation in favor of recovery of the Exchange Act claims because at least one of the lead plaintiff's losses were mostly the result of open market purchases." Pet. App. 271a. Notwithstanding these objections and other alleged conflicts, the district court appointed as "Lead Plaintiffs" over all claimants, with one exception, a unitary group that included the California Public Employees' Retirement System ("CalPERS"), the New York State Common Retirement Fund ("CRF") and the New York City Pension Fund ("NYCPF"). However, because CalPERS had a conflict of interest (relating to its ownership of stock of Merrill Lynch, a PRIDES underwriter) the district court appointed a different lead plaintiff for the PRIDES class. Pet. App. 276a-277a. CalPERS, the CRF and the NYCPF agreed to retain the same counsel and to act jointly in the representation of the class.

The district court justified its decision on the fact that since each member of the group had invested in each of the four types of securities at issue, "the other movants could not rightly challenge the *typicality of its claims*." Pet. App. 270a. [Emphasis added.] The district court further reasoned that the appointed group's presumption of adequacy (because of the larger financial interest of the group over any other movant) was not rebutted because "what matters here is that the claims of every member or constituent group of the putative class arise from the same false or allegedly fraudulent representations of CUC." Pet. App. 272a. The district court then concluded from the foregoing that in pursuit of the large and diverse investments, the group must

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4. The PRIDES were a derivative security based on Cendant common stock. They were issued pursuant to a registration statement virtually identical as to the relevant (and inaccurate) financial statements upon which the Merger shares were issued. The PRIDES offering occurred in February 1998, approximately two months after the Merger in December 1997, and approximately two months prior to Cendant's admission of false financials in April 1998.

be adequate because it "will necessarily seek to establish the elements of every plaintiff's claim." Pet. App. 272a.

On December 14, 1998, Lead Plaintiffs moved the district court for class certification, which was granted on January 27, 1999. No defendant opposed the motion for class certification or the appointment of Lead Plaintiffs as class representative. The class certification order retained the Lead Plaintiffs, as in effect, the sole lead plaintiff with no subclasses created.

3. *The Settlement of the PRIDES Litigation*

As noted, the district court had separated the PRIDES claims from the main Cendant action. The PRIDES Section 11 claims were virtually identical to the Section 11 Claims in the Cendant action since the alleged financial misstatements were virtually identical in the two registration statements. On November 11, 1998, the PRIDES lead plaintiff filed motions for class certification and summary judgment against Cendant under Section 11 of the Securities Act. Before the motions were heard, the parties announced a settlement agreement in which the PRIDES class members were to receive securities worth more than 100 percent of their losses even after the payment of legal fees and expenses.[5] The settlement, which was valued in the total amount of approximately $340 million, was presented to the district court on March 17, 1999 and approved by written decision on June 16, 1999. In approving the settlement, the district court stated, "The Court considers the settlement to be eminently fair and reasonable. The class is completely made whole by such compensation." *In re Cendant Corp. PRIDES Litig.*, 51 F. Supp. 2d at 541.

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5. After the PRIDES settlement was consummated and shortly after the settlement proceeds (i.e., the securities) were issued to class members, the market value of these securities did in fact approximate a 100 per cent recovery of damages.

4. *Settlement of the Main Action and Plan of Allocation*

Meanwhile, Lead Plaintiffs in the main Cendant action agreed with defendants to defer moving for summary judgment on the Section 11 Claims in order to expedite discovery for the Section 10(b) Claims. More than a year after the PRIDES action was settled, Lead Plaintiffs obtained the settlement of all claims against the Cendant defendants and their auditors and a combined settlement fund of $3,186,500,000 was created. The Settlement was preliminarily approved by the district court and a class notice dated April 7, 2000 was issued (the "Class Notice"). The Class Notice included a description of the Plan. The Plan calculated loss amounts per Cendant share, note and option for each day of the class period, based on the amount of artificial inflation caused by CUC and Cendant's issuance of materially false and misleading financial statements. The interests of class members with Section 11 Claims were to be calculated both under the Section 11 damages provision and under Section 10(b), since they possessed both claims, and the class member was to be credited with the larger amount. Class members with Section 11 Claims were given no other credit or benefit.

The Class Notice admitted that: "Prior to formal discovery under the Federal Rules of Civil Procedure, Cendant produced to Lead Plaintiffs (*as part of an agreement for Lead Plaintiffs to defer their motion for partial summary judgment*) over three hundred thousand pages of documents." (Emphasis added.) The motion for partial summary judgment referred to Section 11 Claims, not Section 10(b) Claims. The fact that Lead Plaintiffs admit that they considered pursuing such a motion regarding Section 11 Claims but not Section 10(b) Claims demonstrates that even Lead Plaintiffs understood the Section 11 Claims to be substantially stronger than the Section 10(b) Claims. The statement above further indicates that Lead Plaintiffs willingly negotiated away substantial leverage possessed by Section 11 claimants to bolster the claims of Section 10(b) claimants, an intraclass conflict, and precisely what happened

under similar circumstances in *Amchem*. Furthermore, in paragraph 26(e) of the Class Notice, Lead Plaintiffs argue in favor of the settlement that:

> The risks involved in succeeding at trial against all defendants and collecting from them are substantial. The PSLRA's proportionate liability requirements, under which a defendant may be obligated to pay only for the portion of damages that defendant is held responsible for, may have placed a high proportion of liability on certain individual defendants, who would not have been able to shoulder a substantial amount of damages, and a correspondingly small proportion of liability on Cendant and E&Y.

Although not entirely clear from the Class Notice, the concerns cited above regarding proportionate liability relate *only to Section 10(b) Claims*, not the Section 11 Claims asserted against Cendant. Since they are highlighted as the number one risk factor in favor of the Settlement, they demonstrate a substantial distinction between a Section 11 and Section 10(b) claim that further points out the significant intra-class conflicts that were disregarded by the district court and the Third Circuit.

5. *Petitioner's Objection to the Plan of Allocation*

Petitioner submitted a timely objection to the Plan. She contended that the district court should not approve a Plan that was unfair and inadequate as to Section 11 claimants that resulted from Lead Plaintiffs' substantial and demonstrated conflicts of interest. Her objection further pointed out that the Plan failed to provide class members who had strict liability Section 11 Claims against Cendant (which had no defense to such claims) with any greater portion of the settlement proceeds than class members who had only Section 10(b) fraud claims (which required proof of scienter, were subject to claims of proportionate liability and other defenses). The Plan therefore violated Rule 23 and this Court's landmark decision in *Amchem*.

Because of Lead Plaintiffs' conflicting interests (i.e., representing both Section 11 claimants and Section 10(b) claimants) the Section 11 claimants were grossly under-compensated as compared to the Section 10(b) claimants because the Plan paid all claimants at the same rate. A settlement hearing was held on June 28, 2000 at which the district court considered objections made to various aspects of the Settlement, including the Plan.

6. *The District Court's Decision on the Yeager Plaintiffs' Motion for Summary Judgment*

Long before the district court's consideration of or approval of the proposed settlement and plan of allocation, William P. and Virginia I. Yeager, co-trustees of the William P. Yeager and Virginia I. Yeager Trust (collectively the "Yeager plaintiffs") opted out of the class in the main Cendant action. They moved for partial summary judgment against defendant Cendant for violations of Sections 11 and 12(a)(2) under the Securities Act, 15 U.S.C. §§ 77k, 77*l* and Sections 10(b) and 14(a) under the Exchange Act, 15 U.S.C. § 78n. On August 9, 2000, a week before the district court rendered its decision approving the Settlement and Plan in the main Cendant action, the district court issued its decision and order on the Yeager plaintiffs' motion. *Yeager*, Pet. App. It granted the motion in part and found Cendant liable under Sections 11 and 12(a)(2) of the Securities Act and Section 14(a) of the Exchange Act. The district court also found that there was no issue of material fact as to approximately 75 percent of the damages sought by the Yeager plaintiffs under these provisions. Moreover, the Yeager plaintiffs' Section 11 Claims against Cendant, which were identical to the Section 11 Claims of class members in the main action, were so strong that Cendant actually *conceded liability* entirely and disputed only a small portion of the claimed damages. *Yeager*, Pet. App. 245a-248a.

By contrast, the district court denied summary judgment against Cendant on the Yeager plaintiffs' Section 10(b) claim. It did this for several reasons. First, although certain insider

officers of CUC admitted scienter, that state of mind could not be imputed to Cendant itself without deposition testimony or other direct, concrete proof of the motives of those who authorized and implemented the accounting irregularities. The district court further found that at "this early stage of the litigation," it would be unable to answer even the preliminary question of exactly which CUC or Cendant employees were aware of the fraud. Pet. App. 257a. The district court found that as for the individuals whose "culpable participation" is admitted, no record was developed as to whether the fraud was conducted for their personal benefit or for that of the corporation. "The possibility of adverse interests between the guilty employees and the corporation remains open." *Id.* 233a. Significantly, the district court found that under the PSLRA unlike Section 11, which provides for joint and several liability, Section 10(b) calls for proportionate liability, which can only be determined by a trier of fact.

7. *The District Court's Approval of the Settlement and Plan*

On August 14, 2000, only one week after saying that summary judgment was appropriate for the identical Section 11 claim, the district court approved a "record settlement" agreement reached by Lead Plaintiffs and defendants in the main action. The plan in the Settlement provided that Section 11 claimants and Section 10(b) claimants would receive the same allocation of settlement proceeds, i.e., 37 percent of their damages.[6] In response to Petitioner's objection to the Plan and her related request to represent the HFS shareholders on Section 11 claims only the district court said: (a) the instant settlement and the PRIDES settlements were not comparable because the overall damages in the instant class action were so much greater than the PRIDES settlement and it was in cash as opposed to securities, as in the PRIDES settlement; (b) subclasses were

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6. The district court's approval of the Settlement and Plan was evidenced by various opinions and judgments entered by the district court on August 14 and August 15, 2000 from which Petitioner appealed.

not necessary in the instant action since the district court certified the class for litigation before settlement; and (c) all claims arose from the same "fraudulent scheme."

Notwithstanding, the district court when assessing the "risks of establishing liability" confounded Section 11 liability with that of Section 10(b) and stated the very basis for Petitioner's objections:

> With regard to the Cendant Corporation, in October 1998 [decision on lead plaintiffs' motion to dismiss], the Court wrote: "Basic liability in this case has been conceded by the major corporate defendant." . . . 191 F.R.D. 387 (D.N.J. Oct. 2, 1998). This conclusion stands with regard to Cendant's liability to former HFS shareholders for false and misleading statements in the December 1997 Registration Statement. *See* 15 U.S.C. § 77k . . . .
>
> . . . The risk of establishing basic liability against Cendant is not high, the risk increases, however, when the PSLRA's proportionate liability standard is factored into the equation. [Earlier citing 15 U.S.C. § 78u-4(f)(3)(A).]

Pet. App. 202a.

In addition to the above reasons for rejecting Petitioner's arguments, the district court went on to state:

> Importantly, the members of the *Amchem* and *Ortiz* classes had clear irreconcilable interests. [Citation omitted.] In contrast, CalPERS class members "share common objectives and legal or factual positions." [Citation omitted.] *They all seek the same thing–compensation under the federal securities laws for fraud perpetrated by Cendant and other defendants.* [Emphasis added; citation omitted; second brackets in original.]

Pet. App. 185a-186a.

Nowhere in the district court's Opinion, however, or in the voluminous responses of Lead Plaintiffs opposing Petitioner's objection, is there the slightest analysis of the stark differences between a Section 11 Claim and a Section 10(b) Claim, the entire basis of Petitioner's objection and the most critical element underlying Petitioner's claim that Lead Plaintiffs were conflicted in determining the Plan.

8. *The Court of Appeals Affirmance of the District Court's Approval of the Plan of Allocation*

On August 28, 2001, the Third Circuit issued its opinion and order on the Plan and Settlement, affirming in part, and vacating in part and remanding to the district court. It affirmed the rejection of Petitioner's objections, but on somewhat different grounds than did the district court. Before it turned to Petitioner's argument, in assessing the overall settlement, the Third Circuit took note of the distinction between the joint and several liability provisions of Section 11 of the Securities Act and the proportionate liability scheme called for under the Exchange Act. Further, in summing up the nine factors considered by courts in the Third Circuit as to whether to approve settlements, derived from that court's *Girsh v. Jepson*, 521 F.2d 153 (3d Cir. 1975), Pet. App. 33a-35a, the court concluded that the "fourth factor (risk of establishing liability) weighs more heavily against approval of the settlement with Cendant." Pet. App. 59a. This conclusion was reached as a result of the Third Circuit's disagreement with the district court's analysis of the difficulty in proving Cendant's Section 10(b) liability in the *Yeager* case. The Third Circuit found "on the record before it," that joint and several liability under Section 10(b) could readily be established against Cendant for knowingly (instead of a lesser scienter standard) making false and misleading statements. Pet. App. 44a; *see* 15 U.S.C. § 78u-4(f)(2). Even Lead Plaintiffs did not agree with the Third Circuit's assessment of this risk and asserted that the district court had it right in the *Yeager* case. Moreover, even assuming for the sake of argument that the Third Circuit's conclusion was correct, which Petitioner

disputes, obtaining joint and several liability against Cendant would require years of arduous, time consuming and expensive discovery and all of the uncertainties of a jury trial and possible further appeals. None of these factors apply to the Section 11 Claims.

Petitioner argued in her appeal that the Plan was not fair and reasonable to HFS Section 11 claimants, and that Section 11 claimants should receive more of the settlement and be represented by a different lead plaintiff and separate lead counsel chiefly because liability and damages are easier to prove under Section 11 than under Section 10(b): (a) liability is easier to prove under Section 11 as there is no scienter requirement and thus, a less fact intensive inquiry; and (b) there is no proportionate liability under Section 11, while there is under Section 10(b) if the defendant acted recklessly, but without proof of knowledge. Petitioner further argued that Lead Plaintiffs used the stronger Section 11 Claims as leverage to obtain more recovery for the Section 10(b) Claims. Petitioner made this argument because, as the Third Circuit noted, Lead Plaintiffs agreed to defer a motion for partial summary judgment on its Section 11 Claims in return for Cendant's agreement to permit informal discovery on the Section 10(b) Claims.

The Third Circuit also took note of Petitioner's observation that the two related actions, *Yeager* and *PRIDES*, both resulted in higher recoveries for the Section 11 claimants in those actions, and in *Yeager*, partial summary judgment was granted on liability under the Securities Act and proxy claims. As the Third Circuit noted, "Mark's arguments are not without force." Pet. App. 73a. However, it rejected them. First, it disagreed with both Lead Plaintiffs and the district court that it would be difficult to prove joint and several liability under Section 10(b) (i.e., knowing misconduct on behalf of Cendant). Pet. App. 49a-50a. Second, the court implicitly disagreed with the district court again on the ease with which to prove damages under Section 11. Although the court took notice of the *Yeager* partial summary judgment decision, it misapprehended its holding. Although both the district court and

the Third Circuit noted that there likely could be a "battle of the experts" in regard to damage calculations, the Third Circuit ignored the fact that the district court granted summary judgment for the *Yeager* plaintiffs for almost 75 percent of the damages sought by them, an amount conceded by Cendant. Seventy-five percent is still more than the 37 percent provided for under the Plan, prior to the payment of legal fees and expenses.

The Third Circuit also found that because in the aggregate the Section 10(b) damages were greater than the Section 11 damages, this made the Section 10(b) claims "potentially stronger than the Section 11 claims." Pet. App. 75a n.28. Significantly, the Third Circuit concluded that it was unnecessary that "the respective legal strengths of the § 10(b) and § 11 claims involved should have been factored into the fairness of the settlement determination." Pet. App. 75a. The Third Circuit concluded this before it reached Petitioner's arguments concerning the PRIDES settlement. In regard to the latter, the Third Circuit held that the two actions were not comparable because: (a) the PRIDES settlement "involved a paper payout rather than a cash payout (i.e., the plaintiffs got new Cendant stock for their old stock)," Pet. App. 75a-76a; and (b) the PRIDES settlement was a "claims made" settlement with unclaimed settlement funds reverting back to Cendant whereas any claims not made in the instant settlement inures to the benefit of the class, Pet. App. 76a-77a. Thus, the Third Circuit ignored the district court's statement in the PRIDES settlement opinion worth repeating here: "The Court considers the settlement to be eminently fair and reasonable. The class is completely made whole by such compensation." *In re Cendant PRIDES*, 51 F. Supp. 2d at 541.

9. *The Third Circuit Denies Petitioner's Petition for Rehearing En Banc*

On October 4, 2001, the Third Circuit denied Petitioner's timely petition for *rehearing en banc*. This petition for a writ of certiorari followed. Pet. App. 287a.

REASONS FOR GRANTING THE WRIT

The petition should be granted for several reasons. First, the Third Circuit decided an important question of federal law – how a plan of allocation that purports to resolve conflicting claims satisfies the due process requirements of Fed R. Civ. P. 23 – that has not been, but should be settled by this Court. Second, the Third Circuit has decided the question posed above in a way that squarely contradicts this Court's landmark decision in *Amchem*, which affirmed that the due process requirements of Rule 23 protect absent class members from inadequate settlements (here, an unfair and inadequate plan of allocation) resulting from conflicted class representatives. As a practical matter, the Third Circuit ignored the intra-class conflicts between Section 11 claimants and Section 10(b) claimants, and thus, the Settlement and Plan were not in accordance with Fed. R. Civ. P. 23.

This Court should address the type of allocation and conflicts issues that arose here, and which regularly arise in other securities class actions. This litigation presents an unusually plentiful and strong set of facts that sharply demonstrate how an inadequate plan of allocation results from conflicted class representatives, and how an inadequate plan could have easily been prevented at the outset of the litigation or even during its settlement phase. Moreover, the unusual bounty of facts resulting from the multiple related litigations described in detail above that delineate the issues are not likely to arise in another litigation for many years, if at all. And since this area of the law is regularly subjected to scathing criticism and large doses of cynicism regarding the manner in which securities class actions are prosecuted and settled, there is a strong public interest in the resolution of these troubling issues as was similarly done by this Court in *Amchem*. Accordingly, although this Court's denial of a petition for a writ of certiorari is not a finding on the merits, given the circumstances and notoriety of this litigation, such denial is likely to embolden numerous other lead plaintiffs and class representatives to

disregard genuine intra-class conflicts in the prosecution and settlement of securities class actions.

Although allocation issues almost always lurk under the surface of many securities class actions that involve multiple claims with varying burdens and standards of proof, they do not usually erupt into full-blown litigated disputes. If a district court has done its job under Rule 23 of insuring adequate representation of all class members at the outset of the litigation and in certifying the class, than an adequate plan of allocation should usually follow. With the advent of the PSLRA and the lead plaintiff selection process, many courts, particularly the district court below, have over-simplified the process and tended toward naming fewer lead plaintiffs (and eventually class representatives) and their counsel, to the clear detriment of absent class members. While parsing out appropriate subclasses or designing an adequate plan of allocation in a complex securities class action may be fraught with difficult issues, it should not be ignored or trivialized as it was done here and as it is being done with increasing frequency in other securities class actions. *See Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d 1146 (N.D. Cal. 1999). Accordingly, this Court should grant the Petition.

I. THE CENDANT PLAN OF ALLOCATION FAILED TO RECOGNIZE THE VAST DISTINCTIONS BETWEEN SECTION 11 AND SECTION 10(b) CLAIMS THAT CREATED INTRA-CLASS CONFLICTS AND CONSEQUENTLY VIOLATED BOTH THE PROCEDURAL DUE PROCESS REQUIREMENTS OF RULE 23 AND *AMCHEM*

This Court has long recognized the distinctions between a claim brought under Section 10(b) of the Exchange Act and one brought under Section 11 of the Securities Act. *Ernst & Ernst v. Hochfelder* held that a private cause of action for damages under Section 10(b) and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 will not lie in the absence of an allegation of scienter.

425 U.S. 185, 189 (1976). Later, in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 (1983), the Court held that although the availability of an express remedy under Section 11 of the Securities Act does not preclude defrauded investors of registered securities from maintaining an action under Section 10(b) of the Exchange Act, "the two provisions involve distinct causes of action and were intended to address different types of wrongdoing."

This Court went on to hold that under Section 11 a plaintiff need only show a material misstatement or omission in a registration statement to establish a prima facie case. Further, such an action can only be brought by a purchaser of a registered security and only against certain parties. In stark contrast, Section 10(b) is a "catchall" antifraud provision. It requires a purchase or sale of a security and proof that the defendant acted with scienter. *Id.* at 382. The Court went on to observe that the basic purpose of the Securities Act is to provide greater protection of registered securities.[7]

As the Court observed, Section 11 "was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who plan a direct role in a registered offering." *Huddleston*, 459 U.S. at 381-82. Pertinent to the case at hand, and in particular, defendant Cendant: "If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case. *Liability against the issuer of a security is virtually absolute, even for innocent misstatements.*" 459 U.S. at 382 (emphasis added).

Significantly, the Court observed: "Although limited in scope, Section 11 places a relatively minimal burden on a plaintiff. In contrast, Section 10(b) is a 'catchall' antifraud provision, but it requires a plaintiff to carry a heavier burden to

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7. *See also Huddleston*, 459 U.S. at 382 n.12 ("See H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933) (Section 11 creates 'correspondingly heavier legal liability' in line with responsibility to the public.")).

establish a cause of action." *Id.* (Footnote omitted) Furthermore, this Court found "that the [Securities Exchange] Act and the [Securities] Act [may] 'prohibit some of the same conduct.' " *Huddleston*, 459 U.S. at 383 (quoting *United States v. Naftalin*, 441 U.S. 768, 778 (1979)). Finally, this Court recognized that there are usually a greater number of defendants in a Section 10(b) action than a Section 11 action. *Huddleston*, 459 U.S. at 382 n.13 ("A Section 11 action can be brought only against the issuer, its directors or partners, underwriters, and accountants who are named as having prepared or certified the registration statement. *See* 15 U.S.C. § 77k(a).").

The PSLRA reaffirmed the distinctions between Section 11 claims and Section 10(b) claims and added a few of its own. Outside of certain amendments regarding the selection of lead plaintiffs, the PSLRA made virtually no changes to Section 11. In contrast, Congress imposed greater burdens on plaintiffs to plead and prove a Section 10(b) Claim, and eliminated joint and several liability under the Exchange Act absent proof that the defendants acted "knowingly."

Significantly, the PSLRA imposed a heightened pleading requirement for those bringing actions under Section 10(b). *See* 15 U.S.C. § 78u-4(b). No such provision was added to Section 11. All Circuits to have addressed the issue to date, including the Third, have interpreted the PSLRA to have raised the bar on pleading a Section 10(b) action. *E.g.*, *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534 (3d Cir. 1999) ("In many jurisdictions, adoption of a 'strong inference' standard will substantively heighten the barriers to pleading scienter, a result Congress intended.").

In addition, Congress added Section 201 to the Exchange Act to provide for "proportionate liability" or comparative fault. Under that Section, Congress added several provisions for determination of responsibility by the jury. For example, special jury instructions and interrogatories are to be used at trial, going to: (1) whether the defendant violated the securities laws;

(2) the percentage of responsibility of the defendant "measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff"; and (3) whether the defendant "knowingly" (as opposed to recklessly) committed a violation of the securities laws. 15 U.S.C. § 78u-4(f)(3). In addition, the PSLRA calls for "special interrogatories or findings" to determine the preceding issues and "factors for consideration" in determining the percentage of responsibility under the proportionate liability provisions. 15 U.S.C. § 78u-4(f)(3)(B),(C). These include: "(i) the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiff or plaintiffs, and (ii) the nature and extent of the causal relationship between the conduct of each such person and the damages incurred by the plaintiff or plaintiffs." 15 U.S.C. § 78u-4(f)(3)(C).[8]

Finally, the PSLRA makes a distinction for damage calculations between Section 11 and Section 10(b) claimants adding Section 21D(e) to the Exchange Act entitled "Limitation on damages," 15 U.S.C. § 78u-4(e), but doing nothing similar to the Securities Act. In general, Section 21D(e) limits damages to the difference between the purchase price of the security and the greater of the 90-day mean trading price following the close of the class period or the actual sale price, if the plaintiff sells the security during these 90 days. Under the Securities Act, plaintiffs are entitled to rescission damages, *Randall v. Loftsgaarden*, 478 U.S. 647, 650 (1986), or the difference between the price actually paid for the security in the offering and the price at date of the filing of the complaint. 15 U.S.C. § 77k(e).

The point is that "[i]n significant respects, the interests of those [with Section 11 claims and those with only Section 10(b)

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8. Section 201 applies to Section 11 cases in limited circumstances. It applies to outside directors who sign the registration statement. 15 U.S.C. § 77k(f)(2)(A). The issuer remains jointly and severally strictly liable.

claims] are not aligned," *Amchem*, 521 U.S. at 626, because there are issues as to both liability and damages that vary and conflict between the two and that, in this case, existed but were ignored by Lead Plaintiffs and their counsel and by both the district court and the Third Circuit.

Other courts (some before the PSLRA) have, by contrast, recognized the intra-class conflicts that arise from bringing Exchange Act and Securities Act claims related to the same action, and provide for separate lead plaintiffs for Section 10(b) and Section 11 claims, reasoning that "[t]hese two causes of actions (though they may arise from a common nucleus of operative facts) are distinct in terms of legal theory and requirements of proof. They differ as to the identity of those persons who, in each case, can prove a viable claim, " *Unicorn Field, Inc. v. The Cannon Group, Inc.*, 60 F.R.D. 217, 226-27 (S.D.N.Y. 1973) (quoting *Weiss v. Tenney Corp.*, 47 F.R.D. 283, 287 (S.D.N.Y. 1969). That court also noted, as previously discussed, that "the burden of proof in a § 11 action is far less onerous. With certain exceptions, plaintiff need only demonstrate that the registration statement and prospectus were materially false and misleading and need not prove fraudulent intent on the part of the issuer." *Unicorn Field*, 60 F.R.D. at 227.

In addition, the court noted that under Section 11 "reliance is conclusively presumed." *Id.* Although the court noted that it is not necessary to prove reliance in a fraud on the market case, the court did observe that a Section 10(b) claimant must still demonstrate "some causal nexus between the deception and the injury." *Id.* (citing, *inter alia*, *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). *See also Rothman v. Gregor*, 220 F.3d 81, 95 (2d Cir. 2000) ("To establish [loss] causation [in a Section 10(b) action], a plaintiff must prove 'that the economic harm that it suffered occurred as a result of the alleged misrepresentations' and that 'the damage suffered was a foreseeable consequence of the misrepresentations' [Citation omitted.]"); *Wolfson v. Solomon*, 54 F.R.D. 584 , 588 (S.D.N.Y.

1972) (separate subclasses designated for Section 11 and Section 10(b) claimants); *In re Select Comfort Corp. Sec. Litig.*, 202 F.R.D. 598, 603 (D. Minn. 2001) (to counter "any problems arising from the differing burdens of proof or legal standards of the varying [Securities Act and Exchange Act] claims . . . a single class consisting of two subclasses may be properly certified in this action."); *In re Western Union Sec. Litig.*, 120 F.R.D. 629, 632 (D.N.J. 1988) (two Securities Act subclasses with same representatives; and separate subclass with different representative for Exchange Act claims); *Cf. Freedman v. Value Health, Inc.*, 190 F.R.D. 33, 37 (D. Conn. 1999) (appointing several co-lead plaintiffs and counsel, and requesting briefing on the use of subclasses for Section 11 claimants and Section 10(b) claimants, citing Fed. R. Civ. P. 23(c)(4)); *Aronson v. McKesson HBOC, Inc.*, 79 F. Supp. 2d at 1151 n.4 (appointing one lead plaintiff for both Securities Act and Exchange Act claims, but acknowledging that its ruling would not prevent forming subclasses at the certification stage); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (S.D. Ind. 1966) (same).

II. THE THIRD CIRCUIT IGNORED THE INTRA-CLASS CONFLICTS BELOW THAT REQUIRED THE PLAN OF ALLOCATION TO PROVIDE SIGNIFICANTLY GREATER COMPENSATION TO SECTION 11 CLAIMANTS THAN TO SECTION 10(b) CLAIMANTS

A. *The Standards For Determination Of Subclasses Under Rule 23*

Although subclasses and separate representation are not necessary in all securities class actions with both Section 11 and Section 10(b) claimants, the inadequate and unfair plan of allocation that resulted from the Settlement demonstrates that subclasses were necessary here.

Rule 23(c)(4) authorizes the court to (a) allow a class action to be maintained with respect to particular issues, or (b) to divide

the class into appropriate subclasses. "Rule 23(c)(4) imposes a duty on the court and gives it ample power to 'treat common things in common and to distinguish the distinguishable.' " 7B Charles Alan Wright & Arthur R. Miller, Federal Practice & Procedure § 1790 (2d ed. 2001 Supp.) (quoting *Jenkins v. United Gas Corp.*, 400 F.2d 28, 35 (5th Cir. 1968)). "The usual situation in which a court will divide a class into subclasses under Rule 23(c)(4)(B) is when the class is found to have members whose interests are divergent or antagonistic." Wright & Miller, *supra*. Finally, as the same authority observed, Rule 23(c)(4)(B) "has allowed greater flexibility in maintaining a class action under the federal securities laws." *Id.*, citing *Unicorn Field*, 60 F.R.D. at 227, for the proposition that "[c]auses of action for the violation of Section 11 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 were sufficiently distinct to make the designation of the two subclasses appropriate." Even though there was overlapping of claims, subclasses were appropriate.

> [N]amely, a subclass consisting of all who were original purchasers of shares of stock offered pursuant to the February 15 registration statement, as well as those who purchased such shares between that date and the date suit was brought, and a Section 10(b) class consisting of those who purchased stock during the relevant period and suffered losses as a result of misstatements or omissions in the prospectus.

Wright & Miller, § 1790 n.23, citing *Unicorn Field* and collecting cases.

Further, this Court held that a class containing members with adverse interests could not satisfy Rule 23(a)(4)'s adequate-representation requirement without separately represented subclasses. *Amchem*, 521 U.S. at 608. As the Court noted, under Rule 23(a)(4), representative parties must "fairly and adequately protect the interests of the class," a requirement that "serves to

uncover conflicts of interest between named parties and the class they seek to represent." *Amchem*, 521 U.S. at 594. To comply with this provision, the representative plaintiff "must be part of the class and possess the same interest and suffer the same injury as the class members." *Georgine v. Amchem Prod., Inc.*, 83 F.3d 610, 630 (3d Cir. 1996), *aff'd sub. nom., Amchem*, 521 U.S. 591 (1997). In *Amchem*, the Third Circuit found that the class lacked adequate representation because there were no subclasses even though the class "included a fairly representative mix of futures and injured plaintiffs." *Georgine*, 83 F.3d at 632; *see Amchem*, 521 U.S. at 595 (the proposed settlement contained "no structural assurance of fair and adequate representation for the diverse groups and individuals affected").

Simply because members of a "unitary class" may have overlapping common issues,

> where differences among members of a class are such that subclasses must be established, [there is] no authority that permits a court to approve a settlement without creating subclasses on the basis of consents by members of a unitary class, some of whom happen to be members of the distinct subgroups.

In re Joint E. & S. Dist. Asbestos Litig., 982 F.2d 721, 742-43 (2d Cir. 1992). Even Third Circuit precedent calls for subclassing in circumstances such as this one. *See, e.g., In re General Motors Corp. Pick-up Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768, 800-01 (3d Cir. 1995) (the class failed the adequacy-of-representation requirement because it contained subgroups with antagonistic interests; as a result, the settlement failed to protect the interests of all class members). Thus, courts generally view the formation of subclasses as necessary to the certification of classes with uncommon issues.[9]

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9. Here, petitioner did precisely what the Third Circuit called for in other cases. She sought to have the subclass of Section 11 claimants represented by separate counsel on the plan of allocation aspect of the

(Cont'd)

B. *For Practical Purposes The Class Was Not Certified For Litigation, But For Settlement*

The Third Circuit in the instant matter either rewrote or ignored the record before it primarily for the same reasons as did the district court in *Amchem* – expediency. Observing that Petitioner's objections were "weighty" and that the "question of the fairness of the settlement [ ] factors is closer than District Court made it out to be," the Third Circuit nonetheless rejected Petitioner's arguments. Pet. App. 4a. Further, it is of no moment that the class was certified before settlement. Here, on December 19, 1999, Lead Plaintiffs filed a motion for class certification with no separate lead plaintiff and counsel appointed for the Section 11 claimants. *See Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 857 (1999) ("In *Amchem*, we concentrated on the adequacy of named plaintiffs, but we recognized that the adequacy of representation enquiry is also concerned with the 'competency and conflicts of class counsel. *Id.*, 521 U.S. at 626, n. 20 . . .' ").

The motion for class certification was *unopposed* by defendants and granted by the district court within approximately 30 days of its filing.[10] No class discovery was taken. In addition, hardly any formal discovery of defendants (other than document discovery) was taken by Lead Plaintiffs. Pet. App. 43a. (certain objectors "argue that there was insufficient discovery. In particular, they point to the fact that no depositions were taken . . . [T]he early stage of the discovery means that Settlement was not negotiated 'under a real and credible threat of litigation,' " (citation to brief omitted)). Thus, the circumstances of the settlement was more akin to that of a settlement class than a class certified for litigation purposes.

(Cont'd)

settlement. *See Link v. Mercedes Benz of N. Am., Inc.*, 788 F.2d 918, 930 (3d Cir. 1986) ("If the class representatives did not adequately represent the subclass, the proper remedy was to amend the class certification order or to permit additional plaintiffs to intervene.").

10. Defendant Ernst & Young LLP filed an objection to class certification, which was withdrawn shortly thereafter.

See Amchem, 521 U.S. at 622 (federal courts lack authority to substitute for Rule 23's certification criteria a standard that if a settlement is "fair" then certification is proper).

C. *The Third Circuit Disregarded The District Court's Findings On The Differences Between Section 11 and 10(b) Liability And Damages*

Other objectors as well as Petitioner argued that the risk of establishing liability with Cendant increases when the PSLRA's proportionate liability provisions are factored into the equation. This was essentially why the district court denied summary judgment to the Yeager plaintiffs. Pet. App. 257a-258a ("a reasonable trier of fact could conclude that the true motive of the wrongdoers was the preservation of their employment, salaries, emoluments, and reputations, as well as their liberty, at the expense of the corporation's well-being." *quoting In re Phar-Mor, Inc. Sec. Litig.*, 900 F. Supp 784, 787 (W.D. Pa. 1995)). At the same time, the Third Circuit recognized that "if Cendant were to lose on the § 11 claims at trial, it would be jointly and severally liable on those claims. *See* 15 U.S.C. § 77k(f)." Pet. App. 47a.

However, the Third Circuit made an end run around both the proportionate liability sections of the PSLRA and the district court's holding in the *Yeager* case by relying on pre-PSLRA precedent to find that there would be no "significant risk of establishing joint and several liability against Cendant in this case [under Section 10(b)]." Pet. App. 49a (citing *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 884 (3d Cir. 1975) (stating in *dicta* that "There is no doubt that the fraud of an officer of a corporation is imputed to the corporation when the officer's fraudulent conduct was (1) in the course of his employment, and (2) for the benefit of the corporation")).

The district court, relying on both the proportionate liability provisions of the PSLRA and post-PSLRA case law and considering *Rochez* and defendant Cendant's arguments, conceded that: "without deposition testimony or 'other direct,

concrete proof" of the motives of those who authorized and implemented the accounting irregularities, a ruling that the knowledge of former employees can be imputed to the corporation would be premature." Pet. App. 256a-257a. As the district court noted: "[t]he possibility of adverse interests between guilty employees and the corporation remains open." *Id.*[11]

Significantly, the district court, unlike the Third Circuit, did consider the amendments to the Exchange Act since *Rochez Brothers* was decided.

> That said, it is also noted that the [PSLRA] requires the fact finder to ultimately determine the percentage of responsibility of each person putatively involved, "measured as the percentage of total fault of all persons who caused or contributed to the loss incurred by plaintiff," and "[w]hether such person knowingly committed a violation of the securities laws." 15 U.S.C. § 78u-4(f)(3)(A)(ii)-(iii). Plaintiffs' motion for summary judgment on their Section 10(b) and Rule 10b-5 claims is denied without prejudice.

Pet. App. 259a.

In contrast, the Third Circuit's unsupported conclusion assessing joint and several liability against the corporate defendant for knowingly violating Section 10(b) is devoid of any consideration of the implications of the proportionate liability section of the PSLRA. Indeed, this begs the question whether *Rochez* is still good law after the passage of the PSLRA for the proposition for which the Third Circuit panel relied upon it here.

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11. The district court also relied upon *In re Kidder Peabody Sec. Litig.*, 10 F. Supp. 2d 398, 415-17 n.17 (S.D.N.Y. 1998) (for the proposition that "finding evidence to support a reasonable inference of corporation's scienter where a securities analyst had openly reported hundreds of millions of dollars in false profits, but not deciding imputation issue because of dispute as to whether trader was acting adversely to corporation's interest").

Not only did defendants and the district court believe that establishing a knowing violation of Section 10(b) was a substantial litigation risk, so did Lead Plaintiffs. Pet. App. 49a (in countering another objector's argument that the establishment of knowing conduct on the part of Cendant would be easy to demonstrate, Lead Plaintiff, also relying on *Rochez*, found the district court's reasoning persuasive).

Next, the Third Circuit rejected the record below when it found that "the real difficulty in the trial of this case would have been establishing damages, a process which both Section 10(b) and 11 claimants would have to undergo equally and which almost certainly would devolve into a 'battle of the experts.' " Pet. App. 50a-51a. However, the Third Circuit completely ignored the fact that the district court on summary judgment awarded approximately 75 percent of the damages alleged by the Yeager Plaintiffs under their Section 11 claims, while denying summary judgment to the plaintiffs on Section 10(b). Moreover, the Third Circuit stated erroneously, "[i]n fact, in *Yeager*, the district court denied Yeager summary judgment on his § 11 claim in part because the court found that there was a genuine issue of material fact as to the amount of Yeager's § 11 damages." Pet. App. 74a. This is simply incorrect. The district court did not deny summary judgment to the Yeagers on Section 11 damages. It simply limited their damages to approximately 75% of the alleged amount that was undisputed by Cendant. Pet. App. 261a.

Finally, the Third Circuit concluded that because the Section "10(b) damages available" were greater than the available Section "11 damages," "in this respect the § 10(b) claims are potentially stronger than the § 11 claims." Pet. App. 75a. It appears that the Third Circuit is finding that because the overall settlement was large because of the potential Section 10(b) damages, it must be fair. But this measure of fairness in regard to settlements was expressly rejected by this Court in *Amchem*, 521 U.S. at 621 ("If a fairness inquiry under Rule 23(e) controlled certification, eclipsing Rule 23(a) and (b), and

permitting designation despite the impossibility of litigation, both class counsel and court would be disarmed.").

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DATED AND FILED AUGUST 28, 2001

Filed August 28, 2001

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 00-2520, 00-2683, 00-2708, 00-2709, 00-2733, 00-2734, 00-2769, 00-3653

IN RE: CENDANT CORPORATION LITIGATION

JOANNE A. ABOFF FAMILY TRUST, U/A DATED 2/11/92,

Appellant in No. 00-2520

BETTY DUNCAN,

Appellant in No. 00-2683

TERE THROENLE,

Appellant in No. 00-2708

JANICE G. DAVIDSON; ROBERT M. DAVIDSON, in his capacity as trustee of Robert M. Davidson Charitable Remainder Unitrust, and as co-trustee of Elizabeth A. Davidson Irrevocable Trust, Emilie A. Davidson Irrevocable Trust, John R. Davidson Irrevocable Trust, Emilie A. Davidson Charitable Remainder Unitrust and John R. Davidson Charitable Remainder Unitrust,

Appellants in No. 00-2709

Appendix A

FAYE SCHONBRUNN,

Appellant in No. 00-2733

ANN MARK,

Appellant in No. 00-2734

NEW YORK CITY PENSION FUNDS,

Appellant in No. 00-2769

NEW YORK CITY PENSION FUNDS,

Appellant in No. 00-3653

On Appeal From the United States District Court
For the District of New Jersey
(D.C. Civ. No. 98-cv-01664)
District Judge: Honorable William H. Walls

Argued: May 22, 2001

Before BECKER, *Chief Judge*, SLOVITER and AMBRO, *Circuit Judges*.

(Filed: August 28, 2001)

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Appendix A

OPINION OF THE COURT

BECKER, *Chief Judge.*

* * *

I. Introduction & Summary

These are consolidated appeals from the District Court's approval of a $3.2 billion settlement of a securities fraud class action brought against Cendant Corporation and its auditors, Ernst & Young, and the Court's award of $262 million in fees to counsel for the plaintiff class. Both the settlement and the fee award are challenged in these appeals. The enormous size of both the settlement and the fee award presages a new generation of "mega cases" that will test our previously developed jurisprudence.

This case is governed by the Private Securities Litigation Reform Act of 1995 (PSLRA or Reform Act). Under the Reform Act, one of a district court's first tasks is to select a lead plaintiff. Once the lead plaintiff has been appointed, the statute provides that the lead plaintiff "shall, subject to the approval of the court, select and retain counsel to represent the class." The District Court, after appointing a lead plaintiff, declined to approve its choice of counsel, instead choosing to select lead counsel by means of an auction. The most important question presented by these appeals is whether this decision was compatible with the PSLRA. Closely intertwined, and also of great importance, are issues involving the proper procedures for selecting a lead plaintiff and for awarding counsel fees in cases governed by the Reform Act.

Before we can reach these issues, however, we must decide whether the District Court abused its discretion in approving the settlement and the plan for allocation of damages, to which objections were interposed. Some objectors argue forcefully that the settlement was inadequate under the nine-factor test that this Court developed for reviewing the fairness, reasonableness, and adequacy of class action settlements in *Girsh v. Jepson*, 521 F.2d 153 (3d Cir. 1975). Noting that the class's case was exceptionally strong because Cendant (the main defendant) virtually conceded liability and because some of the plaintiffs' claims (i.e., those presented under § 11 of the Securities Act of 1933) were strict liability claims, these objectors contend that, notwithstanding the threat of bankruptcy if the settlement was too high, a considerably higher figure could have been extracted under these favorable liability circumstances without running the risk that Cendant would seek bankruptcy protection. In their submission, the class should have received a fuller recovery of its alleged $8.8 billion loss.

These objections are weighty, but other *Girsh* factors counsel strongly in favor of approving the Cendant settlement — the reaction of the class, the stage of the proceedings, the risk of establishing damages, the range of reasonableness in light of the possible recovery and the litigation risks, and, though to a lesser degree, the complexity of the litigation. Although we think that the question of the fairness of the settlement under the *Girsh* factors is closer than the District Court made it out to be, our application of those factors supports the conclusion that the District Court did not abuse its discretion in approving the Cendant settlement.

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The issue is even clearer with respect to the settlement between the class and Ernst & Young (E&Y), against which the case was far more difficult. As with Cendant's settlement, the reaction of the class, the risk of establishing damages, and the range of reasonableness of the recovery weigh in favor of approving the E&Y settlement. These factors are augmented by two other *Girsh* factors that weigh strongly in favor of the E&Y settlement: the complexity of litigation and the risk of establishing liability. Because the ability to withstand a greater judgment is the only *Girsh* factor that cuts against approving the E&Y settlement, we conclude that the District Court did not abuse its discretion in approving it.

One objector also argues that the District Court should not have approved the settlement because the entities that comprise the lead plaintiff were too conflicted to represent the class adequately. The bases for this claim are two-fold. First, the institutional investors that make up the lead plaintiff continued to hold Cendant stock during the litigation and settlement process, and thus, the objector submits, had very different motives from other investors who had sold their stock. Second, the lead plaintiff negotiated as part of the settlement certain corporate governance changes that will benefit only those class members that continue to hold Cendant stock. We are unpersuaded by the first argument because it is clear that Congress, in passing the PSLRA, for better or for worse, anticipated and implicitly approved the notion that entities that continued to hold stock in the defendant corporation would serve as lead plaintiffs notwithstanding the existence of many class members who did not. With respect to the second argument, there is no

evidence that the lead plaintiff gave up anything of value to the class members to induce Cendant to agree to the corporate governance changes. We therefore hold that the District Court did not abuse its discretion in approving the settlement.

We then turn to the objections regarding the allocation of the settlement fund. One objector contends that the claims under § 11 of the Securities Act of 1933, which only a subset of the class possesses, are legally stronger than the other claims held by class members, i.e., claims under § 10(b) of the Securities Exchange Act of 1934. Based on this disparity, the objector argues that the § 11 claimants should receive a larger share of the settlement proceeds. We conclude, however, that the § 11 claims here are not necessarily legally stronger than the § 10(b) claims, and that, at any rate, the basis for measuring the different legal strengths of the claims involved is too speculative to support the objector's contention. We thus hold that the District Court did not abuse its discretion in approving a settlement allocation that treated all claims more or less equally.

Having determined that the settlement may stand, we must examine the District Court's award of counsel fees. Because the Reform Act establishes a detailed and integrated process for choosing a lead plaintiff, selecting lead counsel, and approving counsel's fee, we discuss these issues sequentially. In this case, the District Court selected as lead plaintiff a group made up of three pension funds (the CalPERS Group or Lead Plaintiff). Following the dictates of the Reform Act, the court first identified that Group, which is made up of three huge government pension funds, as being the movant with the largest financial interest in the relief

sought by the class. The court then made a preliminary determination that the CalPERS Group satisfied Federal Rule of Civil Procedure 23's typicality and adequacy requirements, which, under the PSLRA, made it the presumptive lead plaintiff. The District Court ultimately appointed the CalPERS Group as lead plaintiff because it determined that no member of the plaintiff class had succeeded in rebutting the statutory presumption. We find no fault with the court's decisions on this score.

The Lead Plaintiff then asked the District Court to appoint as lead counsel two firms with which it had previously negotiated a Retainer Agreement, Bernstein, Litowitz, Berger, & Grossmann of New York City, and Barrack, Rodos & Bacine of Philadelphia. The court declined initially to approve the Lead Plaintiff's choice, deciding instead to select lead counsel via an auction, but giving the CalPERS Group's chosen counsel the option to match what the court determined to be the lowest qualified bid. Those firms exercised this option and were appointed as lead counsel. Following the settlement of the case, and consonant with the results of the auction, Lead Counsel petitioned for and was awarded a sum of $262 million in counsel fees, even though that amount was at least $76 million higher than that provided for under the Retainer Agreement.

We conclude that the court's decision to hold an auction to select lead counsel was inconsistent with the Reform Act, which is designed to infuse lead plaintiffs with the responsibility (and motivation) to drive a hard bargain with prospective lead counsel and to give deference to their stewardship. Although we believe that there are situations

under which the PSLRA would permit a court to employ the auction technique, this was not one of them. Here, inasmuch as the Lead Plaintiff conducted its counsel search with faithful observance to the letter and spirit of the Reform Act, it was improper for the District Court to supplant the CalPERS Group's statutorily-conferred right to select and retain lead counsel by deciding to hold an auction. In sum, we hold that the District Court erred in using an auction to appoint lead counsel; rather it should have done so pursuant to the terms of the Retainer Agreement.

Because the District Court's process resulted in the firms chosen by the Lead Plaintiff being appointed lead counsel anyway, this error was harmless (with regard to the selection of lead counsel). However, because the terms of the Retainer Agreement required the prior approval of the pension funds comprising the CalPERS Group, and that prior approval was not obtained, the fee request here was improper. The fee award must therefore be set aside and this matter remanded to the District Court with instructions to dismiss the fee application and to decline to accept any further applications that are submitted without the prior approval of the Funds.

It goes without saying that the principal focus after remand will be the counsel fee application which will be resubmitted. The parties have extensively briefed and argued the fee award issue, understanding that if the award is set aside the District Court will need guidance on remand. Having this need in mind — along with the fact that this case, in its various facets, has been before this Court seven times now — we will set forth the standards that the court should follow in evaluating a properly-submitted fee request

in Reform Act cases so as to help bring this now protracted matter to a close. Although in general the court should use the same seven-factor test that our cases have developed for reviewing fee requests in other class action contexts, review in PSLRA cases must be modified to take into account the changes wrought by the Reform Act. The biggest change, we believe, is that courts should afford a presumption of reasonableness to fee requests submitted pursuant to an agreement between a properly-selected lead plaintiff and properly-selected lead counsel.

This is not to say, however, that this presumption cannot be overcome. There is an arguable tension between the general schema of the PSLRA on the one hand and its overarching provision that requires the court to insure that counsel fees not exceed a reasonable amount, *see* 15 U.S.C. § 78u-4(a)(6), on the other. We hold that the presumption will be rebutted when a district court finds the fee to be (prima facie) clearly excessive.

For the past decade, counsel fees in securities litigation have generally been fixed on a percentage basis rather than by the so-called lodestar method. Consistent with that approach, we have held that, when the percentage fee is challenged, the Court's obligation to award a reasonable fee will be best exercised by application of the factors described in *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190 (3d Cir. 2000). *Gunter* itself allows for the possibility of a lodestar cross-check, *see id.* at 200, even though the lodestar approach is no longer favored. We conclude that, in determining whether the retainer agreement between the Lead Plaintiff and Lead Counsel is clearly excessive, the court should first

use the *Gunter* factors to evaluate it, for the lodestar cross-check is quite time consuming. But if the court cannot otherwise come to a resolution, it can consider a lodestar cross-check.

In determining whether the presumption of reasonableness of a properly submitted fee request has been rebutted here, the District Court will have to consider the powerful arguments of the objectors that: (1) this was a simple case in terms of liability; (2) the settlement was achieved without a great deal of work by lead counsel; and (3) both the fee award of $262 million under the auction and (potentially up to) $187 million under the Retainer Agreement are staggering in their size, and, on the basis of the evidence in the record, may represent compensation at an astonishing hourly rate (as well as an extraordinarily high lodestar "multiplier").

We conclude by explaining that, if the court's deliberations were to confirm that the fee agreed to by a lead plaintiff and lead counsel was clearly excessive, the court will need to set a reasonable fee according to the standards our previous cases have set down for class actions not governed by the PSLRA.

II. Facts & Procedural History

A. Background

Cendant Corporation, the main defendant, was formed by a December 17, 1997 merger of CUC International, Inc. (CUC) and HFS Incorporated (HFS). Pursuant to a Registration Statement and Joint Proxy Statement/Prospectus, HFS

shareholders tendered their shares in exchange for CUC shares. HFS was then merged into CUC and the combined company was renamed Cendant. Cendant is currently one of the world's largest consumer and business service companies; among its more well-known businesses are Avis, Century 21, and the Ramada and Howard Johnson hotel franchise chains.

On March 31, 1998, Cendant filed its Form 10-K Annual Report with the SEC, which included the company's 1997 financial statements. Two weeks later, after the close of trading on April 15, 1998, Cendant announced that it had discovered "accounting irregularities" in certain units of the former CUC. The notice stated that Cendant expected to restate its annual and quarterly financial statements for 1997 and possibly for earlier periods as well; it also stated that Cendant had retained the law firm Willkie Farr & Gallagher (Willkie Farr) to conduct an investigation into its past financial statements and the allegations of fraud made by some Cendant employees. The next day, Cendant's stock fell 47%, from $35-5/8 to $19-1/16 per share, triggering several class action lawsuits on behalf of investors who purchased CUC or Cendant stock during 1997.

On July 14, 1998, Cendant announced that it would also restate CUC's annual and quarterly financial statements for 1995 and 1996. Following this announcement, Cendant's stock fell by another 9%, to $15-11/16 per share. On August 28, 1998, Cendant filed Willkie Farr's report of its investigation, with the SEC. The report revealed that Cendant would restate its 1995, 1996, and 1997 financial statements by approximately $500 million. On August 31, 1998, the first trading day after Cendant's disclosure of the Willkie Farr

report, Cendant's stock fell another 11%, to $11-5/8. The disclosure of the report triggered several more lawsuits arising from purchases of CUC securities during the broader period of alleged fraud. All told, Cendant shareholders lost more than $20 billion in market capitalization.

Between April and August 1998, at least sixty-four putative securities fraud class action lawsuits were filed nationwide as a result of the above disclosures. Generally speaking, the lawsuits alleged that, from 1995 to 1998, CUC/Cendant had issued a series of materially false and misleading statements in the form of quarterly reports, annual reports, registration statements, prospectuses, and press releases, and that these statements artificially inflated CUC/Cendant's stock price. The lawsuits named as defendants Cendant, its officers and directors, and other parties — including E&Y, which had acted as CUC's independent public accountant from 1983 until the time of the creation of Cendant. E&Y had also performed a post-merger audit of the financial statements of Cendant Membership Services, a wholly-owned subsidiary of Cendant, for the year ending December 31, 1997. The lawsuits alleged that E&Y had issued unqualified reviews and audit opinions certifying CUC's quarterly and annual reports, and that E&Y had failed to adhere to Generally Accepted Auditing Standards and thus lacked any reasonable basis for its opinions and reports.

Cendant eventually filed a cross-claim against E&Y, detailing allegations that E&Y became aware of the fraud long before it was made public but chose to conceal and facilitate it, thereby continuing to garner millions of dollars in fees. Alternatively, Cendant alleged that E&Y was

negligent in failing to discover the fraud earlier. E&Y strenuously denied all the allegations made in the amended cross-claim, pointing out that Cendant had not provided any evidence or documentation to back up the allegations.

By order of the Judicial Panel on Multidistrict Litigation, all cases relating to Cendant's accounting irregularities were transferred to the United States District Court for the District of New Jersey. On May 29, 1998, the District Court consolidated all of them under the caption *In re Cendant Corporation Litigation*.

B. The Appointment of Lead Plaintiff and Lead Counsel

After consolidation, two of the District Court's first responsibilities were to appoint a lead plaintiff and lead counsel to represent the putative class. The PSLRA lays out detailed procedures for courts to follow in making these decisions, directing them to appoint "the most adequate plaintiff" as the lead plaintiff, and instructing them to "adopt a presumption" that the most adequate plaintiff is the movant that "has the largest financial interest in the relief sought by the class" and "otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure." 15 U.S.C. § 78u-4(a)(3)(B)(i) & (iii)(I).[1] The presumption "may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff will not fairly and adequately protect the interests of the class or is subject to unique defenses that render such plaintiff

1. The Reform Act inserted identical amendments into the Securities Act of 1933 and the Securities Exchange Act of 1934. All citations are to the Exchange Act provisions.

incapable of adequately representing the class." *Id.* § 78u-4(a)(3)(B)(iii)(II). With regard to the selection of lead counsel, the statute provides that "[t]he most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class." *Id.* § 78u-4(a)(3)(B)(v).

Fifteen individuals and groups filed motions to serve as lead plaintiff, and the District Court held a hearing on August 4, 1998. It soon became clear that the CalPERS Group — a consortium of the three largest publicly-managed pension funds in the United States: the California Public Employees' Retirement System (CalPERS), the New York City Pension Funds (NYCPF), and the New York State Common Retirement Fund (NYSCRF) — had, by far, "the largest financial interest in the relief sought by the class." According to the District Court, the members of the CalPERS Group alleged combined losses in excess of $89 million, while the largest amount alleged by any other movant was $10.6 million. *See In re Cendant Corp. Litig.*, 182 F.R.D. 144, 147 (D.N.J. 1998). This fact, in conjunction with the District Court's express finding that it satisfied Rule 23's "adequacy" and "typicality" requirements, *see id.* at 147-48, rendered the CalPERS Group the presumptive lead plaintiff.

Two competing movants, the Joanne A. Aboff Family Trust (Aboff) and Douglas Wilson, offered three reasons why the presumption had been rebutted, but the District Court rejected their claims. Aboff and Wilson: (1) contended that they were better suited to be lead plaintiff than the CalPERS Group because they had negotiated a lower fee schedule with their lawyers; (2) argued that the CalPERS Group could not

fairly and adequately protect the interests of the class because one of the Group's chosen counsel had made substantial campaign contributions to the sole trustee of one of the funds that make up the CalPERS Group, thereby creating an appearance of impropriety; and (3) suggested that the District Court should select lead plaintiff "through a process of competitive bidding." *Id.* at 148-49. The District Court concluded that the CalPERS Group could not fairly and adequately represent the interests of the holders of convertible Cendant derivative securities known as PRIDES, *see id.* at 149-50, and severed the PRIDES claims from the main action.[2] The court eventually appointed the CalPERS Group as lead plaintiff of the main *Cendant* action. *See id.* at 149.[3]

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2. The court based this conclusion on the fact that all members of the CalPERS Group had sizeable holdings in Merrill Lynch, a defendant with respect to the claims involving PRIDES. *See id.* at 149. The court eventually appointed a different lead plaintiff and lead counsel in the PRIDES action. *See id.* at 149-50.

3. Although the District Court and some of the parties refer to members of the CalPERS Group as "co-Lead Plaintiffs," we agree with the Securities and Exchange Commission that "[t]here is *one* lead plaintiff under the Reform Act: an individual, an institution or a properly-constituted group." *Brief for the Securities and Exchange Commission as Amicus Curiae*, at 11 n.8 (emphasis added). The statute always speaks of the lead *plaintiff* in the singular, requiring that the court appoint "as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members" and stating that the presumptively "most adequate *plaintiff* . . . *is* the person or group of persons" that satisfies the statute's three threshold requirements. 15 U.S.C. § 78u-4(a)(3)(B)(i) & (iii) (emphasis added).

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The court then turned to selection of lead counsel. The CalPERS Group had filed a motion seeking to have Barrack, Rodos & Bacine (BRB) and Bernstein Litowitz Berger & Grossman LLP (BLBG) appointed lead counsel pursuant to a Retainer Agreement that it had negotiated with them, which dictated not only the formula for determining attorneys fees but also included a Plan for Monitoring Litigation, a section outlining a Theory of Recovery, and a part captioned Consultation Regarding Settlement Negotiations.[4] The

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The biggest consequence of this distinction is that only one "entity" is entitled to speak for the class: *the* lead plaintiff. In cases where a group serves as lead plaintiff, it is for the group's members to decide how the group will make decisions, but it is the group — not its constituent members — that speaks for the class. Afortiori, we use the singular "Lead Plaintiff" throughout this opinion.

4. The Retainer Agreement declares that the members of the CalPERS Group "have agreed to proceed together to seek a Co Lead Plaintiff position," and states that the funds, if selected as Lead Plaintiff, will "seek the appointment of BRB and BLBG as Co Lead Counsel to the Class." The Agreement provides that Lead Counsel will "receive fees, as awarded by the Court, from the proceeds of any judgment or settlement," and that Lead Counsel "will advance all costs and out-of-pocket expenses."

The Retainer Agreement contains four sections set off by roman numerals. The first deals with attorneys fees, providing:

> I. *Attorneys Fees.* The fee will be a function of both the timing and size of the recovery but, unless agreed to by the Funds, will, in no event exceed the following:

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A. Initiation of action through to commencement of discovery:

1. Recovery of $0 to $400 million — fee of 5%;

2. Additional recoveries above $400 million — fee of 3%.

B. Commencement of discovery through to conclusion of all fact and expert discovery:

1. Recovery of $0 to $100 million — fee of 17.5%;

2. Additional recoveries of above $100 million to $300 million — fee of 10%;

3. Additional recoveries of above $300 million to $500 million — fee of 7.5%;

4. Additional recoveries of above $500 million — fee of 5%.

C. Proceedings after conclusion of all discovery, including motions for summary judgment, if any, through and including trial and post-trial proceedings:

1. Recovery of $0 to $150 million — fee of 20%;

2. Additional recoveries above $150 million to $400 million — fee of 12.5%;

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District Court, however, decided to select lead counsel via auction. The court acknowledged that the PSLRA provides that "[t]he most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent

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> 3. Additional recoveries above $400 million — fee of 7.5%
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> In any event, we [i.e., BRB and BLBG] will not submit any fee application to the Court without the prior approval of The Funds, and all fee applications would, of course, be subject to final approval of the Court. Travel, meals and lodging expenses shall be reasonable and subject to the approval of Co-Lead Plaintiffs prior to reimbursement.

Section II is captioned "Plan for Monitoring Litigation," and requires Lead Counsel to: (1) provide the CalPERS Group with "all significant pleadings" at least 24 hours before filing; (2) make monthly status reports, including statements as to time expended and expenses incurred; (3) promptly advise the CalPERS Group of "any significant developments in the case, including settlement discussions"; and (4) schedule periodic meetings to discuss "case developments" and "joint strategies in the prosecution of the case." Section III is captioned "Theory of Recovery," and declares that the goal of the case was "to maximize the recovery obtained from sources outside the corporation . . . without unduly penalizing Cendant or its long-term shareholders." Lead Counsel agreed "to vigorously represent your collective interests, and the interests of the Class, to maximize the recovery for the Class of Cendant securities purchasers in this case, while being cognizant of the interests of the long-term holders of Cendant securities." Section IV is captioned "Consultation Regarding Settlement Negotiations," and it requires Lead Counsel to "consult with" and obtain approval from the CalPERS Group before entering into a final settlement agreement.

the class." 15 U.S.C. § 78u-4(a)(3)(B)(v); *see Cendant Corp. Litig.*, 182 F.R.D. at 150 (quoting this language from the Reform Act). But it reasoned that "the Court's approval is subject to its discretionary judgment that lead plaintiff's choice of representative best suits the needs of the class," and concluded that "mechanisms" other than the lead plaintiff's choice were available to assist the court in making that determination. *Id.* at 150. The court pointed to the "emerging trend" of using auctions "to simulate the free market in the selection of class counsel," and stated that it would hold an auction to select lead counsel and to determine its fee. *Id.* at 150-51. Recognizing that the Reform Act confers upon the Lead Plaintiff the "opportunity" to "select and retain" lead counsel, the District Court ruled that counsel chosen by the CalPERS Group would have the chance to match what the court determined to be the lowest qualified bid. *Id.* at 151. Later, the District Court made clear that any winning bidder would have to agree to comply with all provisions of the Retainer Agreement that the CalPERS Group had negotiated with its chosen counsel (except, of course, the fee grid).

The District Court solicited input about how the auction should be conducted and held a hearing on August 19, 1998. The court eventually required that bids be submitted pursuant to a grid it had designed,[5] and received nine bids to serve as

5. The grid for the main *Cendant* action required that counsel submit a fee in terms of a percentage of the total class recovery. Movants were directed to propose fees depending on the phase at which the litigation was resolved (the horizontal axis) and the size of the eventual recovery (the vertical axis). The phases of litigation

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lead counsel in the main *Cendant* action.[6] The District Court rejected the bid by counsel for appellant Aboff, which would have generated fees of 1-2% of the total settlement depending on the size of the settlement and the timing of the recovery, characterizing it as unrealistic and "quasi-philanthropic," and stating that "[u]nless the eventual monetary recovery in this case is in the billions, such an apparently 'cheap' fee does not make professional sense."[7] In contrast, the court expressly found that counsel proposed by the Lead Plaintiff was qualified and that its proposed fee scale was "realistic," but also concluded that another qualified bidder had submitted a lower "realistic" bid. Counsel chosen by the Lead Plaintiff exercised its power to meet this lower bid, and was thus appointed lead counsel.

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listed on the grid were: from pleadings through adjudication of any motion to dismiss; during discovery through adjudication of a summary judgment motion; after adjudication through a trial verdict; and post-trial. The sizes of recovery listed on the grid were: first 100 million; second 100 million; third 100 million; next 50 million; next 50 million; next 50 million; next 50 million; and over 500 million.

6. The court required that the bids be submitted under seal. This Court recently held that the District Court abused its discretion by imposing such a confidentiality order. *See In re Cendant Corp.*, No. 99-5485, at 23 (3d Cir. Aug. 8, 2001).

7. The case did, of course, settle for an amount well into the billions, reflecting the perspicacity of Mr. Sirota, Aboff's counsel. We need not decide whether Mr. Sirota could have negotiated such a large settlement because we are satisfied that, from the perspective of the District Court at the time, its decision in selecting counsel was not an abuse of discretion.

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C. *Class Certification, the Filing of the Amended Complaint, and the Reaching of a Settlement*

After a case management conference, the newly-appointed Lead Plaintiff filed its Amended and Consolidated Class Action Complaint (the Complaint or Amended Complaint) along with a motion for class certification on December 14, 1998. The Complaint defined the class represented as

> [a]ll persons and entities who purchased or otherwise acquired publicly traded securities . . . either of Cendant or CUC during the period beginning May 31, 1995 through and including August 28, 1998 and who were injured thereby, including all persons or entities who exchanged shares of HFS common stock for shares of CUC stock pursuant to the Registration Statement . . . . Excluded from the Class are: (i) defendants; (ii) members of the family of each individual defendant; (iii) any entity in which any defendant has a controlling interest; (iv) officers and directors of Cendant and its subsidiaries and affiliates; and (iv) [sic] the legal representatives, heirs, successors or assigns of any such excluded party.

The Amended Complaint alleged claims under both § 10(b) of the Securities Exchange Act of 1934 [hereinafter "§ 10(b) claims"] and § 11 of the Securities Act of 1933 [hereinafter "§ 11 claims"], as well as numerous other claims that are not relevant for the purposes of our discussion and decision. The

Complaint set out § 10(b) claims for all class members, but presented § 11 claims only for those class members who received Cendant stock via the HFS merger. CUC, however, acquired via merger fourteen other companies during the class period. As with the HFS merger, these other mergers involved the filing of registration statements with the SEC during the class period, and thus these mergers also gave rise to § 11 claims (as well as claims under § 12 of the Securities Act of 1933) for those who received CUC stock via these mergers.

On January 27, 1999, the District Court granted Lead Plaintiff's motion for class certification, defining the certified class as including "all purchasers or acquirers of Cendant Corporation or CUC International, Inc. publicly traded securities between May 31, 1995 and August 28, 1998 who were injured thereby." Several of the defendants then filed motions to dismiss. In an order issued July 27, 1999, the District Court denied all of them except E&Y's motion to dismiss § 10(b) claims against it that were related to stock purchases made after April 15, 1998. *See In re Cendant Corp. Litig.*, 60 F. Supp. 2d 354 (D.N.J. 1999). On August 6, 1999, the court approved the form of the notice of the class action to be sent to potential class members and ordered its dissemination. The District Court required Lead Plaintiff to mail notice to all record holders of Cendant and CUC stock and to all brokers in the transfer records, and to publish notice of the class action on three different days in *The Wall Street Journal*, *The New York Times* (National Edition), and the *Dow Jones Business Newswire*. In all, the Class Administrator sent 261,224 notices.

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Both the individually mailed and published notices included the definition of the Class as stated in the Complaint, and warned potential class members that if they failed to follow the specific procedures for opting out of the Class, they would be deemed class members and would be bound by any settlement or judgment. The notice stated that any class member who wanted to opt out had to file a written request for exclusion postmarked by December 27, 1999, which served as the final opt-out date.

On December 7, 1999, almost three weeks before the final opt-out date, Cendant announced a proposed settlement that would require it to pay $2.85 billion to the class members, and ten days later the parties announced that a proposed settlement had been reached between E & Y and the Lead Plaintiff (collectively, "the Settlement"). On December 27, 1999, the opt-out period closed pursuant to the class notice. Out of over 100,000 class members, only 234 opted out before the deadline. *See In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 235, 257 (D.N.J. 2000). On March 17, 2000, Cendant and the Lead Plaintiff submitted settlement documents to the District Court, including a Plan of Allocation for the distribution of settlement proceeds among class members.

D. The Terms of the Settlement and the Plan of Allocation

The defendants' obligations under the Settlement consist of three primary elements:

1) **Cash Payment:** Cendant agreed to pay $2,851,500,000 and E&Y agreed to pay $335,000,000

into the settlement pool, which brings the total settlement money to approximately $3.2 billion. Interest will accrue on this money until it is paid out to the Class.

2) **50% of any recovery from E&Y:** Cendant and the individual defendants from HFS Inc. are currently suing E&Y over E&Y's role in the fraud. Fifty percent of any net recovery from this action will go to the Class.

3) **Corporate governance changes:** Cendant will institute corporate governance changes, including putting a majority of independent directors on its Board of Directors; placing only independent directors on the Board's Audit, Nominating, and Compensation Committees; de-classifying the Board and providing for the annual election of all directors; and precluding the repricing of any employee stock option after its grant, except with the approval of a majority of voting shareholders.

In exchange for these undertakings, the Class has agreed to release Cendant, E&Y, the HFS individual defendants, and the CUC individual defendants from all claims that "are based upon, are related to, arise from or are connected with any facts, circumstances, statements, omissions, events or other matters raised or referred to in the pleadings in the Litigation or which could have been asserted against Cendant, the HFS Individual Defendants and the other Released Parties by the Lead Plaintiffs and any Class Member." Stipulation of Settlement with Cendant Corp. and Certain Other Defs. at 12.

The Settlement also contains a Plan of Allocation, which will be used to allocate the settlement money among the class

members. The specifics of the Plan of Allocation are somewhat complex because it involves calculating the "true value" of Cendant/CUC stock for any given day during the class period. To get the "true value" of Cendant stock on any given day, one has to remove from the actual price the artificial inflation that Cendant's fraud caused in the price, a process made trickier by the fact that, unlike many other frauds, the fraudulent statements made by Cendant were not in the form of a surprising announcement that caused the stock to rise a certain amount which would provide a fair indication of how much the fraud affected the price. Instead, Cendant's fraud consisted of releasing financial statements that met the market's expectations, while the truth was that Cendant was falling far short of these expectations.

Cendant did, however, make several announcements revealing the fraud that caused the price of its stock to plummet, namely, the three announcements made on April 15, July 14, and August 28, 1998. The Plan of Allocation works backwards from these price drops to develop an equation for determining the true, non-artificially-inflated value of Cendant stock for any day during the class period. This "true value" is then compared to the actual price of Cendant/CUC stock on that day to determine how much that day's purchasers of Cendant/CUC stock overspent. The Plan uses this amount of overpayment to determine the class members' damages.

The Plan of Allocation also allows class members who had received their stock in CUC's merger with HFS to receive as damages the greater of (1) their damages calculated under § 10(b) as determined by the Plan, or (2) their damages as

calculated under § 11, which would give them the difference between what they paid for the Cendant stock (i.e., the value of the HFS securities that they traded in to get the Cendant stock) and the value of the Cendant stock as of the day the lawsuit was brought (April 16, 1998, the date the first lawsuit was filed). This § 11 provision draws upon the text of the 1933 Act, described in the margin.[8]

Lead Plaintiff's damages expert used the Plan of Allocation's damage determination method to calculate the total damages suffered by the Class from the Cendant fraud as $8.8 billion. At oral argument on this appeal and in a supplemental affidavit, Lead Plaintiff represented that the

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8. Title 15 U.S.C. § 77k (the codification of § 11 of the 1933 Act) actually provides for three ways of determining § 11 damages: (1) the difference between the amount paid for the stock and the stock's price the day the lawsuit was brought (the method used above); (2) the difference between the amount paid for the stock and the amount received for it when it was sold, if it was sold before the lawsuit was brought; and (3) the difference between the amount paid for the stock and the amount received for it when it was sold, if it was sold after the lawsuit was brought but before judgment, only if such damages are less than the damages as calculated under (1). *See* 15 U.S.C. § 77k(e). Only (1) is relevant to this case, however. Regarding option (2), if the class members sold their stock before April 16, 1998 (the day the lawsuit was brought) they would have no damages — the fraud was not revealed until after trading ended on April 15, 1998, so the stock price before April 16 was at least as artificially inflated by the fraud at the sale of the stock as it was at the purchase. Regarding option (3), because the price of Cendant stock continued to decline after the day the lawsuit was filed as more fraud was revealed, this option would result in greater damages than those calculated under (1) and thus cannot be used under the provisions of 15 U.S.C. § 77k(e).

Claims Administrator had received over 118,000 proofs of claim from class members, for a total of $4.9 billion claimed losses. The $3.185 billion cash payment in the Settlement thus represents approximately a 36% recovery rate on the Class's total losses and a 64% recovery rate on the actually claimed losses. Of the $4.9 billion claimed losses, approximately $2.1 billion are losses claimed by class members who acquired Cendant stock in the HFS merger deal.

E. Preliminary Settlement Approval, the Settlement Notice, the Attorneys Fees Request, and the Fairness Hearing

On March 29, 2000, the District Court granted preliminary approval to the proposed settlement and enjoined all actions or claims that were contemplated by it. In early April, pursuant to the order containing the settlement approval, the Class Administrator mailed 478,000 notices of the Settlement and proof of claim form packages [hereinafter "the Settlement Notice"] to potential class members, and also published notices in *The Wall Street Journal* and *The New York Times*. The Settlement Notice summarized the course of the litigation and the terms of the Settlement, including Lead Plaintiff's Plan of Allocation of the settlement funds. It also informed the class members that Lead Counsel intended to submit an application for attorneys fees totaling 8.275% of the total settlement fund and for reimbursement of expenses in the amount of $15,855,000. The Notice stated that the District Court would conduct a fairness hearing on June 28, 2000, and contained information about how class members could go about objecting to the Settlement. It provided that any class member could appear at the fairness hearing to object

to the Settlement. Class members were also allowed simply to state an objection to the Settlement in writing, although, as we discuss below in Part III.A.2, there is some dispute over how clear the Settlement Notice was on this point.

Prior to the fairness hearing, Lead Counsel petitioned the District Court for an award of $262,468,857 in attorneys fees and $14,623,806 in expenses. Lead Counsel noted that its fee request "adhere[d] precisely to the parameters in the lowest qualified bid proposal" established by the court's auction.[9] At the hearing on the request to approve the Settlement and for counsel fees, six parties raised objections to the substantive provisions of the Settlement. Three were class members (Betty Duncan, Ann Mark, and Tere Throenle); two were not class members (Martin Deutch, a derivative plaintiff, and the State Board of Administration of Florida, which opted out of the Class); and one was a party whose class status is unclear (the Davidsons).[10] Four class members

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9. In contrast, had the District Court not held the auction and appointed Lead Counsel pursuant to the Retainer Agreement that it had negotiated with the CalPERS Group, *see supra* n.4 and accompanying text, the maximum allowable fee — "unless agreed to by The Funds" — would have been approximately $187 million.

10. Janice and Robert Davidson, for themselves and as trustees of trusts for the benefit of their children (collectively, the Davidsons), have participated in this appeal as objectors to the Settlement. The procedural history of their claims presents a special situation. On June 20, 2000, in response to a motion by the Davidsons for clarification of the class definition specifying that they were not class members or, in the alternative, an extension of time for them to opt out of the Class, the District Court issued an order that: (1) ruled (Cont'd)

filed objections to the fee request: NYCPF (a member of the CalPERS Group); Aboff; Faye Schonbrunn; and Throenle.

August 15, 2000, the District Court formally approved the Settlement, entering two opinions and orders approving the Settlement and Plan of Allocation and rejecting all of the objectors' objections. *See In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 235 (D.N.J. 2000); *In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 273 (D.N.J. 2000). On August 16, 2000, the District Court filed an opinion and order awarding Lead Counsel approximately $262 million in attorneys fees pursuant to the schedule that had been pre-set via the auction.

(Cont'd)
that the Davidsons were covered by the class definition and thus were included in the Class; (2) refused the Davidsons' request for an extension of time to opt out of the Class; and (3) enjoined the Davidsons from arbitrating their claims in California, an action which they had initiated on December 17, 1998. *See In re Cendant Corp. Sec. Litig.*, 194 F.R.D. 158 (D.N.J. 2000). The Davidsons appealed this order. On May 9, 2001, two weeks before oral argument in the present appeal, a panel of this Court filed an opinion affirming in part and reversing in part the District Court's June 20, 2000 Order. In particular, the panel majority generally affirmed the court's Order but left the extent of the scope of the matters to be arbitrated to the arbitrator. However, the full Court has since voted to rehear the Davidsons' appeal en banc, thereby vacating the panel opinion, so at this time it is not clear whether the Davidsons will be held to be class members, whether they will be given an extended time to opt out of the Class, or whether they will be permitted to pursue their claims in arbitration. If any of these possibilities comes to pass, the Davidsons' objections in this appeal will be mooted. However, for reasons set forth *infra* at Part III.C, we will take up the Davidsons' objections in this opinion.

See In re Cendant Corp. Sec. Litig., 109 F. Supp. 2d 285 (D.N.J. 2000). Several of the objectors appealed these rulings.

F. The Appeals and the Issues Presented by Each Appeal

This opinion addresses three appeals from the District Court's approval of the Settlement and the Plan of Allocation, and four appeals from its award of counsel fees.[11] These appeals were consolidated for argument. On appeal, the objectors to the Settlement and the Plan of Allocation are:

> **Tere Throenle (00-2708):** Throenle challenges the overall fairness to the Class of the Cendant part of the Settlement, and contends that the Lead Plaintiff suffered from a conflict of interest that prevented it from fairly representing all class members because it continued to hold Cendant stock during and after the settlement negotiations.[12]

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11. This is the seventh appeal from this case that this Court has heard so far. The preceding six are: *In re Cendant Corp.*, No. 99-5485 (3d Cir. Aug. 8, 2001); *In re Cendant Corp. Litigation*, 2001 WL 487903, No. 00-2185 (3d Cir. May 9, 2001) (this is the Davidsons' appeal that gave rise to the since-vacated opinion and is now pending an en banc hearing, *see supra* n.10); *In re Cendant Corp. PRIDES Litigation*, 243 F.3d 722 (3d Cir. 2001); *In re Cendant Corp. PRIDES Litigation*, 235 F.3d 176 (3d Cir. 2000); *In re Cendant Corp. PRIDES Litigation*, 234 F.3d 166 (3d Cir. 2000); *In re Cendant Corp. PRIDES Litigation*, 233 F.3d 188 (3d Cir. 2000).

12. Throenle purchased 100 shares of Cendant stock during the class period and lost approximately $600.

Betty Duncan (00-2683): Duncan challenges the overall fairness to the Class of the E&Y part of the Settlement.[13]

Ann Mark (00-2734): Mark claims that the proposed allocation of the settlement money among the Class is unfair because class members with § 11 claims should have received more than class members with § 10(b) claims.[14]

The Davidsons (00-2709): The Davidsons contend that the District Court erred by not making explicit Fed. R. Civ. P. 23 findings when certifying the Class; that the notice given to the Class was insufficient; that there are intra-class conflicts arising from the disparate treatment of class members under the terms of the Settlement; and that the Plan of Allocation is flawed.[15]

Objector Deutch's contentions are addressed in a separate opinion by this panel. *See In re Cendant Corp. Sec. Litig. (Deutch)*, No. 00-2684 (3d Cir. Aug. 28, 2001). Objector State Board of Administration of Florida did not appeal.

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13. Duncan bought an unspecified number of CUC notes and claims a loss of $1,294.

14. Mark exchanged 100 shares of HFS for 240 shares of CUC in the HFS merger and also purchased 400 Cendant shares in the open market during the class period.

15. The Davidsons held a substantial amount of CUC stock stemming from the merger of their company into CUC, although it is not clear from the record or the briefs exactly how many shares they held or how large their losses were.

Appendix A

The objectors to the court's award of counsel fees are:

NYCPF (00-2769; 00-3653): NYCPF argues that the District Court's decision to select lead counsel by means of an auction was inconsistent with the PSLRA, and contends that the Retainer Agreement negotiated between the Lead Plaintiff and Lead Counsel remains in effect. It also contends that the fee award approved by the District Court constitutes an excessively high percentage of the recovery given the circumstances.

Aboff (00-2520): Aboff argues that the fee award was "grossly excessive," and also claims that the notices that were sent to class members did not contain sufficient information so as to allow them to evaluate the reasonableness of the fee request.

Throenle (00-2708): Throenle contends that the fee request was improper and excessive.

Faye Schonbrunn (00-2733): Schonbrunn argues that the District Court ignored this Court's jurisprudence governing fee requests, and claims that the court's award was excessive.[16]

Securities and Exchange Commission (SEC): The SEC appears as *amicus curiae*, contending that auctions are generally not consistent with the Reform Act.

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16. For the most part, Schronbrunn's arguments are duplicative of, or subsumed by, those made by other objectors. Accordingly, we will not identify them separately.

Appendix A

Barclays Global Investors, N.A. et al (the Barclays Group): The Barclays Group appears as *amicus curiae*, arguing that the auction in this case was improper because there was no reason to believe that the Lead Plaintiff lacked the capacity or willingness to negotiate vigorously in the counsel selection and retention process.

The District Court had jurisdiction pursuant to 15 U.S.C. §§ 77v & 78aa and 28 U.S.C. § 1331, and we have jurisdiction under 28 U.S.C. § 1291.

III. The Fairness of the Settlement and the Plan of Allocation

The objectors' arguments as to the fairness and adequacy of the Settlement fit into two basic categories. First, they argue that the District Court erred in applying the nine-factor test that we developed in *Girsh v. Jepson*, 521 F.2d 153 (3d Cir. 1975), for determining whether a settlement is fair, reasonable, and adequate under Federal Rule of Civil Procedure 23(e). Second, they contend that the District Court erred in approving the Settlement because there were serious intra-class conflicts that caused the Lead Plaintiff to represent the Class inadequately in negotiating the Settlement. *See, e.g., Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997). We review the District Court's approval of a class action settlement, including its determination that the settlement was fair, reasonable, and adequate, for abuse of discretion. *See In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liability Litig.*, 55 F.3d 768, 782 (3d Cir. 1995) [hereinafter "*GM Trucks*"].

Appendix A

A. Approval of the Settlement: The Application of the Girsh *factors*

Rule 23(e) sets out the basic charter for a court's analysis of the fairness of a class action settlement. It provides: "A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." We have interpreted this rule to require courts to " 'independently and objectively analyze the evidence and circumstances before it in order to determine whether the settlement is in the best interest of those whose claims will be extinguished.' " *GM Trucks*, 55 F.3d at 785 (quoting 2 Herbert Newberg & Alba Conte, *Newberg on Class Actions* § 11.41). Under Rule 23(e), the District Court acts as a fiduciary guarding the rights of absent class members and must determine that the proffered settlement is "fair, reasonable, and adequate." *Id.*

In approving the Settlement, the District Court applied the nine-factor test this Court developed in *Girsh*, which provides the analytic structure for determining whether a class action settlement is fair, reasonable, and adequate under Rule 23(e). *See id.* The nine *Girsh* factors are:

(1) the complexity, expense and likely duration of the litigation;

(2) the reaction of the class to the settlement;

(3) the stage of the proceedings and the amount of discovery completed;

(4) the risks of establishing liability;

(5) the risks of establishing damages;

(6) the risks of maintaining the class action through the trial;

(7) the ability of the defendants to withstand a greater judgment;

(8) the range of reasonableness of the settlement fund in light of the best possible recovery; and

(9) the range of reasonableness of the settlement fund in light of all the attendant risks of litigation.

See Girsh, 521 F.2d at 157. The proponents of a settlement bear the burden of proving that these factors weigh in favor of approval. *See GM Trucks*, 55 F.3d at 785.

Objectors Throenle and Duncan submit that the District Court abused its discretion in its application of the *Girsh* test to this settlement. In particular, Throenle argues that a correct application of the *Girsh* factors weighed against the settlement with Cendant, and Duncan raises a similar argument as to the settlement with E&Y.[17] Because there is

17. Throenle does raise some points against the settlement with E&Y as well, but the bulk of her argument centers on the Cendant settlement.

substantial overlap between Throenle's and Duncan's arguments, we will consider these arguments together, noting any differences where relevant.[18] In our review of the District

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18. Duncan raises another argument that we dispose of summarily. *GM Trucks* held that a district court reviewing a proposed class action settlement should make a preliminary determination, under which a presumption of fairness for the settlement is established if the court finds that: (1) the negotiations occurred at arms length; (2) there was sufficient discovery; (3) the proponents of the settlement are experienced in similar litigation; and (4) only a small fraction of the class objected. *See GM Trucks*, 55 F.3d at 785. Duncan contends that the District Court should not have accorded the Settlement a threshold presumption of fairness because there was insufficient discovery directed to uncovering E&Y's involvement in the fraud, which, she submits, compels the conclusion that the Lead Plaintiff's negotiations with E&Y were not at arms-length. More specifically, Duncan argues that there is a strong possibility that three Cendant former employees who have pled guilty to federal criminal charges arising from this fraud may eventually give testimony implicating E&Y more fully in this fraud. (The three former employees are Cosmo Corigliano, the former chief financial officer; Anne Pember, a former senior vice president and controller; and Casper Sabatino, a former vice president of accounting and financial reporting. Duncan refers to these three as "the three felons.") Duncan asserts that "this Court can reasonably conclude that the testimony of the three felons will ultimately establish the fraudulent intent by E&Y." *Duncan's Opening Br.* at 40.

We reject this argument for two reasons. First, Duncan uses the wrong standard of review. She says that this Court "can reasonably conclude" that more discovery will lead to more information against E&Y; the question, however, is not what this Court can reasonably conclude, but whether the District Court abused its discretion in finding otherwise. *See GM Trucks*, 55 F.3d at 782, 785. Second, E&Y

(Cont'd)

Appendix A

Court's application of the *Girsh* factors, we will first consider the strength of each side's arguments on each factor, and then, based on the totality of the factors, determine whether the District Court abused its discretion in finding overall that the *Girsh* factors weighed in favor of the Settlement.

(Cont'd)
points out in its brief that Sabatino told investigators that he and others at Cendant took steps to deceive E&Y as to the existence of the fraud. This is corroborated by the Willkie Farr Report on the Cendant fraud, which states that Cendant officials tried to conceal the fraud from E&Y. Indeed, the SEC also filed a complaint against Corigliano, Pember, and Sabatino on the date of their guilty pleas which accused them of lying to E&Y and of withholding material information from E&Y. These factors support the conclusion that E&Y was not an active participant in the fraud but was itself deceived by Cendant officials, rendering Duncan's contentions that the Corigliano, Pember, and Sabatino testimony will reveal E&Y's fraud an exercise in optimism.

In sum, Duncan's arguments here are built on pure speculation that relies almost exclusively on the naked allegations made in Cendant's complaint against E&Y. *See supra* Part II.A. Moreover, Duncan's "wait and see" approach to the E&Y settlement (i.e., waiting for further discovery to develop) would likely mean a substantial delay to the Class in receiving settlement money even though there is no evidence that, given time, more information implicating E&Y would come to light. Therefore, we reject Duncan's arguments that there was insufficient discovery regarding E&Y's involvement, and we thus conclude that it was not an abuse of discretion for the District Court to give an initial presumption of fairness to the Settlement.

Appendix A

1. The First *Girsh* Factor: Complexity, Expense & Likely Duration of Litigation

This factor captures "the probable costs, in both time and money, of continued litigation." *GM Trucks*, 55 F.3d at 812 (internal quotation marks and citation omitted). The District Court found that this case would involve complex and protracted discovery, extensive trial preparation, and difficult legal and factual issues, and that this factor therefore weighed in favor of approval of the Settlement. The court focused on a number of specific variables that increased the case's complexity: the number of defendants; the complex accounting issues involved with respect to damages; the need for expert review and testimony; the fact that Cendant and E&Y were blaming each other for the accounting errors; and the possibility of unknown novel legal issues raised by the PSLRA. The court also found that litigation would likely be drawn out, with an extended discovery period necessary and a trial date that would likely not occur until 2002. *See In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d at 256-57.

The objectors counter with a number of arguments. Throenle's best argument is that the liability aspect of the case against Cendant is simple — Cendant basically admits that its employees had the requisite scienter for § 10(b) liability, and there is strict liability for Cendant on the § 11 claims — so that the only truly contested issue is damages. She adds that the District Court's denial of the defendants' motions to dismiss means that the plaintiffs have surmounted the most formidable barrier posed by the PSLRA, namely, the heightened pleading standards put in place by the Act. As to the complexity of the case against E&Y, Duncan argues

that we will not know enough about this issue until the parties engage in more discovery to determine E&Y's involvement. She asserts that if the three Cendant employees who pled guilty to fraud implicate E&Y in their testimony, *see supra* n.18, the plaintiffs' case against E&Y will be uncomplicated.

We find Throenle's objections with respect to the Cendant portion of the Settlement to have considerable merit. We agree with Throenle's contention that Cendant's basic liability does not present a difficult or complex issue. Cendant has indicated that, insofar as liability is concerned, it would argue at trial that it is not responsible for any illegal actions taken by its employees because these acts were not done to benefit Cendant. However, because (as we explain below) we are skeptical of the viability of this defense for Cendant, *see infra* Part III.A.4, the fact that Cendant would likely raise it increases only minimally the complexity and likely duration of the litigation. We are thus dubious that this case, insofar as it involves Cendant's liability, presents numerous complex legal and factual issues that would result in substantial costs of time and money. But this does not necessarily militate against an attractive settlement, a point we address later.

The issue of damages against Cendant is different in character, for it involves technical accounting issues and hence can be quite complex. Thus, we agree that this factor weighs in favor of settlement insofar as the damages determination is concerned. We note in this regard that the damages determination formula developed by the Lead Plaintiff's damages expert is complicated and difficult to follow; if Cendant constructed its own damages determination formula (as we presume it would), the damages issue could

appreciably lengthen and complicate this litigation. Still, we think that, compared to a case in which basic liability is contested, the damages issues involved here would increase only moderately the time and expense required to litigate.

Regarding Duncan's arguments on the complexity of determining E&Y's liability, we note that E&Y has consistently and strenuously denied any fault for this fraud, and as we have explained, *see supra* n.18, there does not seem to be good reason to think that the three convicted Cendant employees will implicate E&Y. E&Y points out that the fraud was perpetrated at Cendant facilities by Cendant employees, and no evidence has surfaced in the investigations following the fraud that E&Y employees participated in or even knew about the fraud. E&Y also emphasizes the fact that the Willkie Farr report describes numerous instances in which Cendant employees admitted concealing or falsifying information to prevent E&Y from discovering the truth. We agree with E&Y that establishing liability and damages against it would involve fairly complex and protracted litigation.

In sum, while the complexity and duration of litigation factor does not weigh as heavily in favor of settlement as the District Court concluded, we do think it does weigh somewhat in favor of the Cendant part of the Settlement, and strongly in favor of the E&Y part of the Settlement.

2. The Second *Girsh* Factor: The Reaction of the Class

The District Court found that this factor cut strongly in favor of the Settlement, as the number of objectors was quite

small in light of the number of notices sent and claims filed. The claims administrator sent 478,000 notices of the Settlement to potential class members, and also published notices in *The Wall Street Journal* and *The New York Times*. Over 30,000 settlement claims were filed as of June 12, 2000 (more than two weeks before the fairness hearing), and almost 120,000 claims were filed by May 15, 2001. Yet only four class members objected to the Settlement (Throenle, Duncan, the Davidsons, and Mark, who objected only to the Plan of Allocation), and only two non-class members objected as well (Deutch and the State Board Administration of Florida). As the District Court noted, none of the objectors was an institutional investor (although the Davidsons had very large holdings), and only 234 class members opted out of the Class; the court took the latter number "as an extremely favorable indicator of class reaction." 109 F. Supp. 2d at 257.

Throenle argues that the low number of objectors is attributable to the confusing notice to the Class; she contends that the notice implied that objectors had to appear personally before the court to lodge objections. Throenle also asserts that she had difficulty obtaining relevant documents from the clerk's office before the objection deadline, and that "[s]uch a fundamental deprivation of due process very likely hindered [other] objectors." Throenle Br. at 47. Duncan submits that the number of objectors and opt-outs is "meaningless" because the opt-out and objection-filing deadlines occurred before the three arrested Cendant employees pled guilty.

The District Court correctly found that this factor weighed strongly in favor of the Settlement. The vast

disparity between the number of potential class members who received notice of the Settlement and the number of objectors creates a strong presumption that this factor weighs in favor of the Settlement, and the objectors' arguments otherwise are not convincing. Although it is true that the Settlement Notice could have been clearer on how to object to the Settlement, the District Court pointed out that the notice provided the address and phone numbers for Lead Plaintiff's counsel in the event that class members had questions about any matter in the notice. *See* 109 F. Supp. 2d at 255. A confused class member who wanted to make an objection could have easily called class counsel and clarified the process by which to make it. Throenle's assertion about her difficulty in obtaining documents from the clerk's office is troubling, but the fact is that she did receive the relevant documents in time and no other class member has complained of this problem. Furthermore, Duncan's contention that more people would have objected had the objection deadline date occurred after the three Cendant employees pled guilty to fraud is purely speculative; nothing in these employees' statements to investigators implicates E&Y, and in fact the statements reflect that they tried to conceal the fraud from E&Y. We therefore conclude that this factor cuts strongly in favor of the Settlement.

3. The Third *Girsh* Factor: The Stage of Proceedings

This factor "captures the degree of case development that class counsel have accomplished prior to settlement. Through this lens, courts can determine whether counsel had an adequate appreciation of the merits of the case before negotiating." *GM Trucks*, 55 F.3d at 813. In considering this

factor, the District Court took note of the formal and informal discovery in which Lead Counsel had engaged, and then concluded that "[t]he record reveals, and the Court finds, that the parties understood the merits of the class action and could fairly, safely and appropriately decide to settle the action with Cendant and E&Y. Counsel conducted extensive discovery, retained and used experts, and litigated pre-trial motions." 109 F. Supp. 2d at 259 (internal quotation marks and citation omitted). The court then described in detail the "extensive discovery" undertaken by the Lead Counsel, which included analysis of Cendant's public filings, review of the Willkie Farr Report, review of various documents produced by Cendant during informal and formal discovery, and interviews with various Cendant and E&Y employees. *See id.* at 258-59. The court also noted that, in preparation for settlement negotiations, Lead Plaintiff had retained the investment firm Lazard Freres and damages expert Forensic Economics, Inc., to assist it in determining damages. *See id.* at 258.

Both Throenle and Duncan argue that there was insufficient discovery. In particular, they point to the fact that no depositions were taken and that Lead Counsel mainly engaged in only informal discovery. Duncan in particular argues that the early stage of discovery means that the Settlement was not negotiated "under a real and credible threat of litigation." Duncan's Opening Br. at 52.

The objectors are correct that the Settlement was reached early in the litigation, with discovery itself at an early stage. However, the merits of the liability case against Cendant were fairly clear. With respect to the § 11 claims, Cendant has

admitted that its financial statements contained materially false information, and Cendant has strict liability for its registration statements that incorporated these financial statements. As for the § 10(b) claims, Cendant employees have basically admitted committing fraud, so Cendant was going to be on the hook for a substantial amount, if not all, of the Class's § 10(b) damages at all events. In its argument on the fourth *Girsh* factor (the risk of establishing liability), Lead Plaintiff relies on the fact that Cendant has advanced the defense that it should not be held liable for the Class's damages that were caused by the illegal acts of its various officers, because these acts were not done for the benefit of the corporation. As we explain below, *see infra* Part III.A.4, on the record before us we do not think that Cendant would have much chance of success with this defense. While it is not clear whether Lead Plaintiff had an "adequate appreciation" of the merit of this defense, its viability turns more on legal considerations than on factual development, *see id.*, so it does not substantially affect Throenle and Duncan's claim that more discovery was needed.

Given the foregoing, it is unclear what depositions and interrogatories (with the requisite motions to compel) would have added to the liability considerations. It is true that the extent of the Class's damages was not clear-cut, but Lead Plaintiff retained its own damages expert to calculate the Class's damages and also reviewed a damages report prepared by the National Economic Research Association, Inc., which Cendant hired as its damages expert. The issue of damages appears to have been headed for resolution as a battle of the experts at trial. While Federal Rule of Civil Procedure 26 expert witness discovery might have been helpful on the

damages issue, it is not clear what it would have added to the settlement calculus.

Therefore, although this litigation was settled at an early stage, because of the nature of the case Lead Plaintiff had an excellent idea of the merits of its case against Cendant insofar as liability was concerned at the time of the Settlement. Lead Plaintiff also underwent a sufficient process for determining the Class's damages before the Settlement. Because of this, Lead Plaintiff was able to form an "adequate appreciation of the merits of the case [against Cendant] before negotiating." *GM Trucks*, 55 F.3d at 813. We thus conclude that this factor cuts strongly in favor of the settlement with Cendant.

Because the case against E&Y was strongly contested and much more complex, it is correspondingly more difficult to ascertain the merits of the case against E&Y because of the early settlement. However, Duncan's conjecture about what evidence of E&Y's involvement in the fraud may turn up from further discovery is undermined by the results of the investigation of the three former Cendant employees charged with criminal fraud, which indicates that they concealed the fraud from E&Y. *See supra* n.18. Therefore, although we note the possibility that further discovery might have illuminated the merits of the case against E&Y, we temper this with the observation that it seems unlikely that evidence of E&Y's further involvement in the fraud would come to light. For these reasons, we conclude that the stage of proceedings factor is neutral as to the settlement with E&Y.

4. The Fourth *Girsh* Factor: The Risks of Establishing Liability

A court considers this factor in order to "examine what the potential rewards (or downside) of litigation might have been had class counsel decided to litigate the claims rather than settle them." *GM Trucks*, 55 F.3d at 814. The District Court concluded that the risks of establishing liability varied with the particular defendant. As to Cendant, the court concluded that liability was easily established, but that things got more complex for the § 10(b) claims when the proportionality of liability was considered: "the jury might have found that Cendant bore only a small proportion of the responsibility for the damages suffered by the Class." 109 F. Supp. 2d at 260 (internal quotation marks omitted) (citing the PSLRA's provisions on proportionate liability, which provide that a defendant is jointly and severally liable on a § 10(b) claim only if the defendant knowingly committed the fraud; otherwise the defendant is only liable for the percentage of his responsibility for the fraud, *see* 15 U.S.C. § 78u-4(f)[19]). Proportionality of liability is only an issue as

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19. 15 U.S.C. § 78u-4(f) provides, in pertinent part:

(f) Proportionate liability

(2) Liability for damages

(A) Joint and several liability

Any covered person against whom a final judgment is entered

(Cont'd)

to the § 10(b) claims; if Cendant were to lose on the § 11 claims at trial, it would be jointly and severally liable on these claims. *See* 15 U.S.C. § 77k(f).

(Cont'd)

> in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.
>
> (B) Proportionate liability
>
> (i) In general
>
> Except as provided in subparagraph (A), a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that covered person, as determined under paragraph (3).

Paragraph 3 of § 78u-4(f) provides in pertinent part that the factfinder should make findings as to "the percentage of responsibility of [the defendant], measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff."

As to E&Y, the court reasoned that the level of scienter required by § 10(b), E&Y's potential due diligence defenses under Section 11, and the fact that there was no evidence that E&Y knew about the fraud while it was being committed meant that Lead Plaintiff faced significant obstacles in establishing E&Y's liability. The court concluded that this factor weighed strongly in favor of settlement in E&Y's case, less so for Cendant, and "overall [this factor] weighs in favor of settlement." 109 F. Supp. 2d at 261.

Throenle concentrates her argument on the District Court's conclusion that the risk of establishing liability with Cendant increases when the PSLRA's proportionate liability provisions are factored into the equation. She counters that, although the PSLRA limited defendants' joint and several liability in § 10(b) actions, defendants who are found to have *knowingly* committed § 10(b) violations are still jointly and severally liable for the fraud damages under the PSLRA. *See* 15 U.S.C. § 78u-4(f)(2). She thus argues that, because Cendant would be charged with knowing whatever its employees knew and its employees knowingly committed the fraud, Cendant would be jointly and severally liable, not proportionately liable, on the § 10(b) claims. On this basis, Throenle submits that the proportionate liability provisions of the PSLRA really do not pose a risk to establishing Cendant's liability.[20]

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20. Duncan's argument on this factor is that further discovery would turn up evidence establishing E&Y's liability. As we have noted above, this claim is not only speculative, but also undermined by the evidence in the record. Thus, we agree with the District Court's conclusion that the risk of establishing E&Y's liability is substantial.

Lead Plaintiff counters Throenle's argument by pointing to *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975), in which we set out a two-part test for determining when the fraud of an officer of a corporation is imputed to the corporation: the fraud is imputed "when the officer's fraudulent conduct was (1) in the course of his employment, and (2) for the benefit of the corporation." *Id.* at 884. Lead Plaintiff notes that Cendant argued in the District Court that it was not liable for the illegal acts of its officers because these acts were not for Cendant's benefit, and that Cendant used just this defense to defeat a summary judgment motion on § 10(b) claims by an opt-out plaintiff in this very case. *See In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 225, 232-34 (D.N.J. 2000) [hereinafter "*Yeager v. Cendant*" or "*Yeager*"]. The court denied the plaintiff's summary judgment motion in *Yeager* because of the possibility that "a reasonable trier of fact could conclude that the true motive of the wrongdoers was the preservation of their employment, salaries, emoluments, and reputations, as well as their liberty, at the expense of the corporation's well-being." *Id.* at 233 (internal quotation marks and brackets omitted). Lead Plaintiff contends that the possibility that Cendant could establish this defense to limit its liability posed a risk of establishing liability, so that the District Court correctly concluded that this factor weighed in favor of the Settlement.

We do not agree with the District Court that there was a significant risk of establishing joint and several liability against Cendant in this case. *Rochez Brothers* makes clear that a corporate officer's fraud is imputed to the corporation "even if the officer's conduct was unauthorized, effected for his own benefit but clothed with apparent authority of the

corporation, or contrary to instructions." 527 F.2d at 884. The reason for this is that "a corporation can speak and act only through its agents and so must be accountable for any acts committed by one of its agents within his actual or apparent scope of authority and while transacting corporate business." *Id.* Based on the record before us, it would not seem difficult for the plaintiffs to establish that the high-ranking CUC officers who published the false financial statements in CUC's name were acting within the apparent scope of their authority and were transacting corporate business, whether or not they were feathering their own nest.

In sum, we agree that there would be little risk in establishing Cendant's joint and several liability on the § 10(b) claims. As to the risk of establishing E&Y's liability, we agree with the District Court's analysis that a number of factors make this factor weigh strongly in favor of approval of the E&Y portion of the Settlement: the lack of any evidence that E&Y knew about the fraud; E&Y's due diligence defenses on the § 11 claims; the complexity of the case against E&Y; and the prospect of fierce litigation. Overall, then, the risks of establishing liability factor cuts substantially in favor of approval of the E&Y portion of the Settlement, but cuts against approval of the Cendant portion of the Settlement.

5. The Fifth *Girsh* Factor: The Risks of Establishing Damages

Like the fourth factor, "this inquiry attempts to measure the expected value of litigating the action rather than settling it at the current time." *GM Trucks*, 55 F.3d at 816. Lead Plaintiff presented evidence to the District Court that the total

amount of damages to class members ranges between $8.5 and $8.8 billion. Lead Plaintiff cautioned, however, that establishing damages at trial would lead to a "battle of experts," with each side presenting its figures to the jury and with no guarantee whom the jury would believe. The District Court accepted this argument, as well as E&Y's statement that it was prepared to prove at trial that the decline in Cendant's stock following the announcements of the fraud was largely due to factors and conduct in which E&Y was not involved. The court thus found that this factor weighed in favor of settlement.

Throenle and Duncan do not offer persuasive arguments regarding this factor, and we find the District Court's reasoning on this factor sound. As we set forth in the margin, the damages determination proffered by Lead Plaintiff's expert is complex and hard to follow, freighted with involved calculations and conceptually difficult issues.[21] Were a jury confronted with *competing* expert opinions of corresponding complexity, there is no compelling reason to think that it would accept Lead Plaintiff's determination rather than Cendant's, which would posit a much lower figure for the Class's damages. This risk in establishing damages means that this factor weighs in favor of approval of the Settlement.

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21. For example, as we stated in the Facts & Procedural History section, the damages determination involves calculating the "true value" of Cendant/CUC stock for any given day during the class period, i.e., the value that the stock would have had if the fraud had not been committed, which requires a complex and conceptually difficult damages determination.

6. The Sixth *Girsh* Factor: The Risks of Maintaining the Class Action Through Trial

The District Court found that this factor slightly weighed in favor of settlement because, "[u]nder Federal Rule of Civil Procedure 23(a), a district court 'may decertify or modify a class at any time during the litigation if it proves to be unmanageable,' " and proceeding to trial would always entail the risk, even if slight, of decertification. *In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d at 262 (quoting *In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 148 F.3d 283, 321 (3d Cir. 1998)). The objectors argue that this factor is really neutral. In our view the risk of decertification appears to be extremely slight; hence we agree with the objectors.

7. The Seventh *Girsh* Factor: The Ability of the Defendants to Withstand a Greater Judgment

There is a dispute among the parties as to what this factor means, i.e., whether it concerns the ability of the defendants to withstand a judgment for the $8.8 billion maximum damages sought by the Class, as Lead Plaintiff and E&Y argue, or whether it focuses on the ability of the defendants to withstand a settlement or a judgment for any amount higher than the $3.2 billion for which they are settling, as the objectors contend. The District Court took note of this dispute, but appears not to have taken a position on it, as it found that there was insufficient financial data to determine what the defendants could afford to pay.

Lead Plaintiff and E&Y reason that the use of the term "judgment" rather than "settlement" in the formulation of

this *Girsh* factor supports their contention that it concerns only the possible judgment at trial for the full amount of damages sought rather than other possible larger settlements. This reasoning is not terribly persuasive, because *Girsh* uses the phrase "the ability of the defendants to withstand a *greater* judgment," 521 F.2d at 157 (emphasis supplied), and the comparative term "greater" implies a comparison with the current settlement. If this factor was intended to reference the ability of the defendants to withstand a judgment for what the plaintiffs claim as their damages, then it would presumably be stated in those terms (e.g., "the ability of the defendants to withstand a judgment for what the plaintiffs claim") rather than as "the ability of the defendants to withstand a greater judgment." Furthermore, because both a settlement and a judgment take money out of Cendant's pocket, distinguishing the two in the context of this factor makes little sense from a practical point of view.

We think a better interpretation of this factor is that it is concerned with whether the defendants could withstand a judgment for an amount significantly greater than the Settlement. Our case law supports this view. *See In re Prudential*, 148 F.3d at 321-22 (finding no error in the district court's analysis of this factor that considered whether the defendant could withstand a judgment for an amount greater than the proposed settlement); *GM Trucks*, 55 F.3d at 818 (same). Thus, our consideration here is whether Cendant could withstand a judgment for an amount significantly greater than $2.85 billion, and whether E&Y could withstand a judgment for an amount significantly greater than $335 million. The District Court concluded that, although the defendants failed to produce financial information that

showed that they could not pay a judgment greater than what the Settlement provided, this was not enough to reject the Settlement because the other factors cut clearly in favor of settlement. However, the District Court went on to find that

> at least as far as Cendant is concerned, objective benchmarks support Lead Counsel and Cendant's stance that sustaining a larger judgment, and possibly even a larger settlement, might prove fatal. Particularly, the significant percentage of Cendant's market capitalization that will be paid to the class — approximately 25-30%. Even more striking is that Lead Plaintiffs' total damages calculation [i.e. the $8.8 billion] represents approximately 80-95% of [Cendant's] market capitalization (depending on market close) — a figure difficult for this Court to imagine Cendant paying without seeking shelter in our bankruptcy laws.

109 F. Supp. 2d at 263.

Thus, while the District Court did not find that Cendant could not pay more than the $2.85 billion it contributed to the Settlement, it did find that if this case went to trial and Cendant was held liable for an amount close to $8.8 billion, it would probably declare bankruptcy. Regarding E&Y's ability to withstand a greater judgment, the court did not have any of E&Y's financial information before it, so it could not ascertain whether E&Y could pay more than its $335 million share of the Settlement. The court then determined that, because of the lack of financial information, this factor weighed neither for nor against the Settlement.

Throenle and Duncan argue that the District Court erred when it found that this factor was neutral, because both Cendant and E&Y are able to pay greater amounts than they would under the Settlement. Throenle contends that Cendant's announcement after the Settlement was reached that it was resuming its share repurchasing activity shows that Cendant has the ability to pay significantly more than $2.85 billion. Duncan points to E&Y's post-settlement sale of its consulting business to Cap Gemini for $11 billion as evidence of the need to get more information as to E&Y's ability to pay more.

We agree with the objectors' contentions that the defendants could afford to pay more than they did under the Settlement. This does not end our analysis of this factor, however. The District Court was surely right that somewhere between Cendant's settlement payout ($2.85 billion) and the potential judgment ($8.8 billion), Cendant would likely be tipped into declaring bankruptcy. It is not clear on the record where this point would occur — it is probably not clear even to Cendant's directors at this point — but it is very likely that bankruptcy would have been a risk if Cendant were faced with a substantially higher judgment. There is inevitably a measure of speculation involved in this determination, especially given the lack of record development on this issue, so even though we think that it is likely that both Cendant and E&Y could have paid substantially more than they did under the Settlement, we must remain cognizant that the possibility of bankruptcy is quite real when the settlement or judgment numbers sufficiently increase. At the same time, the proponents of a settlement bear the burden of proving that the *Girsh* factors weigh in favor of approval. *See GM Trucks*, 55 F.3d at 785.

Given these observations, we disagree with the District Court that the ability to withstand a greater judgment factor is neutral with regard to the Settlement. Rather, we think that this factor cuts against approval of the Settlement, albeit only moderately, because of the built-in limitations of this kind of analysis and the lurking possibility of bankruptcy for Cendant (and perhaps E&Y as well) if faced with a judgment near $8.8 billion.

8. The Final *Girsh* Factors: The Range of Reasonableness of the Settlement Fund in Light of the Best Possible Recovery & in Light of Litigation Risks

The District Court began its analysis of these factors by noting that the maximum amount of total damages against all defendants is approximately $8.5 billion (later amended to $8.8 billion), so that the total settlement amount of nearly $3.2 billion from all defendants represents a 36-37% recovery rate by the plaintiff Class. "This far exceeds recovery rates of any case cited by the parties." *In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d at 263 (citing cases and a volume describing a range of recoveries from 1.6% to 14% for securities class action settlements[22]). Because Cendant paid

22. The District Court cited the following: Denise Martin et al., National Economic Research Association, Inc., *Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions* 10-11 (1996) (securities settlements range from 9%-14% of claimed damages); *In re Prudential Sec., Inc. L.P. Litig.*, MDL No. 1005, 1995 WL 798907 (S.D.N.Y. Nov. 20, 1995) (approving settlement of between 1.6% and 5% of claimed damages); *In re Crazy Eddie Sec. Litig.*, 824 F. Supp. 320 (E.D.N.Y. 1993) (settlement of between 6% and 10% of damages); *In re Michael Milken & Assocs. Sec. Litig.*, 150 F.R.D. 57 (S.D.N.Y. 1993) (7.5%).

the bulk of the $3.2 billion settlement, the court considered the proportionate fairness of the E&Y settlement separately. E&Y was only potentially liable for $6.2 billion in damages (i.e., the damages sustained by pre-April 15, 1998 purchasers), and, if E&Y and Cendant bear equal responsibility for these damages,[23] then E&Y's settlement payment of $335 million represented 9.25% of the damages for which it was responsible. The court found that this was in line with the range of recoveries referenced above, and that it was well above the norm for recoveries against accounting firms in securities litigation.

The objectors' arguments about these factors challenge the District Court's calculations, contending that the Class's damages were $13 to 20 billion rather than $8.8 billion, so that the recovery rate for the Settlement would be much lower than the District Court concluded. These arguments are flawed, however, because they calculate the Class's damages by using the drop in Cendant's market capitalization after the fraud was revealed. A stock's drop in market capitalization is not a proper measure of damages in securities cases under the statutory scheme laid out in § 10(b) or § 11. *See* 15 U.S.C. § 77k(e) (§ 11 damages) & § 78u-4(e) (§ 10(b) damages). Thus, the objectors' arguments are unavailing.[24]

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23. This is of course a highly questionable proposition insofar as the § 10(b) claims were concerned, as it appears from the record that Cendant would likely bear a much higher proportionate responsibility than E&Y for the fraud.

24. The reason why a drop in market capitalization is an inaccurate determiner of damages can be clarified by the following (Cont'd)

Furthermore, we find the District Court's conclusion that these factors weigh in favor of the Settlement to be persuasive. The fact that the recovery rate for the Class here apparently exceeds the recovery rates in other securities class action settlements tends to support the reasonableness of the Settlement even though the Class faced low litigation risks in its claims against Cendant (because of the relative ease of establishing Cendant's liability). The lower recovery rate of E&Y's portion of the Settlement is justified by the greater litigation risks the Class faced in establishing E&Y's liability. For these reasons, we conclude that these factors weigh in favor of approval of the Settlement.

9. Summing Up the *Girsh* Factors

Insofar as the Cendant portion of the Settlement is concerned, we conclude that the second (reaction of the

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example. Suppose that Samantha Shareholder bought one share of Cendant stock at $20. The stock then rose to $25, but when the fraud was announced it dropped to $15, whereupon Shareholder sold. Shareholder's damages are $5 because that is the difference between what she paid for the stock and what she sold it for after the fraud was revealed ($20-$15); these are her "out-of-pocket" damages. *See Sowell v. Butcher & Singer, Inc.*, 926 F.2d 289, 297 (3d Cir. 1991) ("The proper measure of damages to reflect the loss proximately caused by the defendants' deceit is the out-of-pocket rule. That rule is the traditional measure of damages in a Rule 10b-5 action.") (internal quotation marks and citation omitted). If we used the drop in market capitalization to determine Shareholder's damages, however, we would conclude that she had damages of $10 ($25-$15), which is greater than her out-of-pocket loss and is thus not a proper measure of her damages.

class), third (stage of the proceedings), fifth (risk of establishing damages), eighth and ninth (range of reasonableness in light of the best possible recovery and of litigation risks) *Girsh* factors all weigh strongly in favor of approval of the settlement with Cendant. The first factor (complexity of litigation) weighs moderately in favor of approval, while the seventh factor (ability to withstand a greater judgment) weighs moderately against approval and the fourth factor (risk of establishing liability) weighs more heavily against approval of the settlement with Cendant. Finally, the sixth factor (risk of maintaining the class action) is effectively neutral.

As to the E&Y portion of the Settlement, we conclude that the first (complexity of litigation), second (reaction of the class), fourth (risk of establishing liability), fifth (risk of establishing damages), eighth and ninth (range of reasonableness in light of the best possible recovery and of litigation risks) *Girsh* factors all weigh strongly in favor of approval of the Settlement. The third factor (stage of the proceedings) and the sixth factor (risk of maintaining the class action) are neutral, while the seventh factor (ability to withstand a greater judgment) weighs moderately against the E&Y portion of the Settlement.

Given this analysis, we conclude that the District Court did not abuse its discretion in finding that the *Girsh* factors overall weighed in favor of approving the Settlement and that therefore the Settlement was fair, reasonable, and adequate. As should be clear from our analysis, we think that this question with respect to the Cendant portion of the Settlement is closer than the District Court made it out to

be. In particular, the lack of any serious risk of establishing Cendant's liability and its probable ability to pay substantially more in settlement raise concerns in our minds concerning the fairness and adequacy of this Settlement. However, a quick reference to the preceding discussion of the *Girsh* factors makes clear that the balance clearly weighed in favor of approval of the Cendant settlement. As to E&Y, there can be no question as to the propriety of the approval. Furthermore, under our standard of review applicable here we accord deference to the District Court's exercise of discretion, and can set aside its decision only if there was an abuse of that discretion, which is absent here. For these reasons, we hold that the District Court did not abuse its discretion in concluding that the Settlement was fair, reasonable, and adequate based on its application of the *Girsh* factors.

B. Intra-class Conflicts

Throenle and Mark have presented objections to the Settlement that fall under the general rubric of intra-class conflicts. Throenle presents two related arguments for setting aside the District Court's order approving the Settlement, while Mark attacks the Plan of Allocation.

1. Throenle's Arguments

a. The Lead Plaintiff's Alleged Conflicts of Interest

Throenle first argues that the members of the CalPERS Group (who comprise Lead Plaintiff) were too conflicted to serve adequately in that capacity because they continued to

hold huge amounts of Cendant stock during the Settlement negotiations, rendering them more concerned with protecting their interests in Cendant's future prospects than with achieving maximum recovery for the Class from Cendant. Throenle's argument is based on the general assertion that a lead plaintiff who retains a substantial investment in a defendant corporation cannot adequately represent a class in a lawsuit against that corporation because this lead plaintiff will naturally be conflicted between trying to get maximum recovery for the class and trying to protect its ongoing investment in the corporation, e.g., by settling cheap or by securing corporate governance changes in lieu of cash, both of which are alleged here. Because of this, she argues that we should set aside the Settlement.

Throenle's thesis is attractive. The problem with it is that Congress seems to have rejected it when it enacted the lead plaintiff provisions of the PSLRA. The Reform Act establishes a presumption that the class member "most capable of adequately representing the interests of class members" is the shareholder with the largest financial stake in the recovery sought by the class. 15 U.S.C. § 78u-4(a)(3)(B)(i) & (iii)(I). The plaintiff with the largest stake in a given securities class action will almost invariably be a large institutional investor, and the PSLRA's legislative history expressly states that Congress anticipated and intended that such investors would serve as lead plaintiffs. *See* S. Rep. No. 104-98, at 11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690 ("The Committee intends to increase the likelihood that institutional investors will serve as lead plaintiffs by requiring the court to presume that the member of the purported class with the largest financial stake in the

relief is the 'most adequate plaintiff.' "). We presume that Congress was aware that an institutional investor with enormous stakes in a company is highly unlikely to divest all of its holdings in that company, even after a securities class action is filed in which it is a class member.

By establishing a preference in favor of having such investors serve as lead plaintiffs, Congress must have thought that the situation present here does not inherently create an unacceptable conflict of interest. *See id.* ("The Committee believes that an institutional investor acting as lead plaintiff can, consistent with its fiduciary obligations, balance the interests of the class with the long-term interests of the company and its public investors."). For this reason, the simple fact that the institutional investors who comprise Lead Plaintiff retained Cendant stock while the Settlement was negotiated is not nearly enough, standing alone, to support Throenle's claim that Lead Plaintiff was so conflicted that the Settlement should be overturned.[25]

Throenle appears implicitly to acknowledge this point, because she also argues that there is specific evidence that

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25. Although we have held that the fact that the members of the CalPERS Group continued to hold Cendant stock does not warrant overturning the Settlement, we call attention to an issue of potential intra-class conflicts with which district courts will need to grapple in future cases at the class certification stage. *See In re Party City Securities Litigation*, 189 F.R.D. 91, 108-10 (D.N.J. 1999) (noting the possibility of a significant conflict in many securities class actions between the interests of individuals and institutions that purchased and then sold stock in the defendant firm — "Sell Plaintiffs" — and those who bought and continue to hold such stock — "Hold Plaintiffs"). (Cont'd)

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In economic terms, the potential conflict may be demonstrated as follows. The motivation of a rational Sell Plaintiff is simple: he wants to secure the largest possible recovery. The rational Hold Plaintiff, however, is in a more complicated situation; her goal is to reach a settlement that will maximize the combined value of her share of the settlement and the stock that she continues to hold in the defendant firm. Consequently, though a rational Sell Plaintiff would be perfectly willing to push the defendant firm one dollar short of declaring bankruptcy, a rational Hold Plaintiff rarely would be so willing because the increased value of her share of the settlement fund would almost certainly be offset by a corresponding decrease in the value of her stock. Thus, there will often be a significant conflict between the interests of Sell Plaintiffs and Hold Plaintiffs, particularly in cases where the class's expected damages are very large. We acknowledge that settlements among market participants are not always a function of rational behavior, as economists assume. Indeed, most settlements are probably based on intuition — although market factors doubtless inform the exercise of the parties' judgment.

What is important to realize, however, is that this issue is one of class configuration. It is not merely a problem with the identity of the lead plaintiff, because it is equally problematic to have a Sell Plaintiff represent a class that includes Hold Plaintiffs as it is to have a Hold Plaintiff represent a class that includes Sell Plaintiffs. Properly understood, the issue is whether the conflict between the interests of Sell Plaintiffs and Hold Plaintiffs in a particular case is sufficiently severe so as to prevent a putative class from satisfying Rule 23's requirements for class certification, regardless whether the problem is seen as one of commonality, *see* Fed. R. Civ. P. 23(a)(2) (providing that a class action may be maintained only if "there are questions of law or fact common to the class"), typicality, *see* Fed. R. Civ. P. 23(a)(3) (permitting class certification only if "the claims or defenses of the representative parties are typical of the claims or defenses of the class"), adequacy of representation, *see* Fed. R. Civ. P. 23(a)(4)

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Lead Plaintiff did not adequately represent the Class's interests in this case, and that this evidence rebuts the PSLRA's presumption that the CalPERS Group was the most adequate plaintiff. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II) (providing that the presumption that the largest shareholder is the most adequate plaintiff "may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff . . . will not fairly and adequately protect the interests of the class"). Throenle points to two factors as evidence that Lead Plaintiff did not adequately protect the Class's interests. The first is that while some people originally placed the Class's total damages at $13-20 billion, Cendant only paid $2.85 billion, which is too low a percentage of the Class's total damages. Her second piece of evidence is that Liberty Media Co. agreed to invest $400 million in Cendant soon after the announcement of the Settlement; because Lead Plaintiff must have known about this impending deal "[t]his obviously gave the Lead Plaintiffs

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(stating that a class may be certified only if "the representative parties will fairly and adequately protect the interests of the class"), or predominance, *see* Fed. R. Civ. P. 23(b)(3) (allowing for class certification if "the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members"). Because here no party on appeal objects to class certification based on conflicts between Sell Plaintiffs and Hold Plaintiffs, we need not decide whether this matter should have been certified as two separate classes or as a single class with sub-classes. We do, however, call these issues to the attention of district courts for future cases, and note that the use of separate classes or sub-classes is not inconsistent with the Reform Act because that statute deals with the identification of a lead plaintiff, and not with the proper means for defining a class in the first place.

— to the extent they retained substantial Cendant holdings — a tremendous incentive to settle cheap." Throenle's Opening Br. at 31.

Throenle does not clearly explain how she concluded that the Class's damages were $13-20 billion; apparently it is derived from Cendant's loss of market capitalization caused by the announcement of the fraud. As we noted above in our *Girsh* factor analysis, however, loss in market capitalization is not a proper measure of damages in § 10(b) or § 11 cases. *See* 15 U.S.C. § 78u-4(e) (§ 10(b) damages) & § 77k(e) (§ 11 damages); *supra* Part III.A.8. Thus, Throenle's argument based on this $13-20 billion figure has no legitimate basis and we reject it for that reason.

Similarly, Throenle's accusations about the Cendant-Liberty Media deal are based upon speculation; she offers no evidence that Lead Plaintiff knew about this impending deal or that it affected the settlement calculations, except for the fact that the deal was announced soon after the Settlement was announced (nine days later). Furthermore, even if this speculation were correct, Throenle's argument on its own is not persuasive. It is unclear how this impending deal, if Lead Plaintiff knew of it, "obviously gave Lead Plaintiff . . . a tremendous incentive to settle cheap," as Throenle contends. Why would an upcoming infusion of cash investment in Cendant impel Lead Plaintiff to settle this litigation cheaply? Lead Plaintiff would have such an incentive only if: (1) Liberty Media made the deal contingent upon Cendant achieving a favorable settlement of this case; (2) Lead Plaintiff became aware that Liberty Media had taken this position; and (3) Lead Plaintiff determined that the Liberty

Media deal was worth more to it (as a current shareholder of Cendant) than a larger settlement was worth to it (as a class member). As with her other charges, Throenle offers no evidence that any of these suppositions are true. For these reasons, we reject Throenle's assertion that Lead Plaintiff was in conflict with the interests of the class members so that the Settlement should be overturned.

b. The Corporate Governance Changes

Throenle also argues that the corporate governance changes that Lead Plaintiff obtained from Cendant as part of the Settlement benefitted only institutional investors who continued to hold large blocks of Cendant stock, and not the Class as a whole, so that the District Court abused its discretion in approving a settlement that provided an individual benefit to certain class members at the expense of more recovery for the Class overall.

The corporate governance changes that Lead Plaintiff negotiated include Cendant's agreement to: (1) ensure that a majority of its Board of Directors would be independent directors; (2) place only independent directors on the Board's Audit, Nominating, and Compensation Committees; (3) de-classify the Board and provide for the annual election of all directors; and (4) preclude the repricing of any employee stock option after its grant, except with the approval of a majority of voting shareholders. Although these corporate governance changes were not negotiated until after the monetary portion of the Settlement was agreed upon, Lead Plaintiff did make it known to Cendant at the beginning of the negotiation process that it was going to ask for corporate

governance changes. Obviously, these changes benefit only current and future Cendant shareholders, as they are meant to reduce the chance of future fraud by limiting the control of Cendant's internal officers and directors. The Lead Plaintiff, however, was appointed to represent the interests of the Class, which is defined as all persons who purchased Cendant stock between May 31, 1995 and August 28, 1998, many of whom have long since sold their shares.

On the basis of these facts, which are essentially undisputed, Throenle argues that the inclusion of the corporate governance changes in the Settlement warrants overturning the Settlement. She acknowledges that she has no evidence that Lead Plaintiff gave up something in the negotiations (presumably up-front dollars) in order to get the corporate governance changes. Throenle's argument is thus based upon the common sense premise that "you don't get something for nothing." Throenle contends that the only thing of value that Lead Plaintiff had to offer Cendant for the governance changes was its acceptance of less money for the Class. Therefore, Throenle maintains, Lead Plaintiff sold out the interests of the class members (by accepting less money than it could have gotten) in order to get something of value for itself and for other current and future Cendant shareholders. Under this view, Lead Plaintiff breached its duty to the Class in negotiating these corporate governance changes, and the District Court abused its discretion in approving the Settlement given this conflict.

Throenle's argument here has an intuitive pull, but ultimately it is unpersuasive for two reasons. First, the received wisdom of the street does not necessarily have force

in this Court as a matter of law. The truth of the maxim "you don't get something for nothing" is not something that we can judicially notice. We need evidence, and there is no affirmative evidence backing up Throenle's claims, although there is some evidence against them. Lead Plaintiff strenuously denies that it took any less monetary recovery to get the corporate governance changes. Apparently, the corporate governance changes were not negotiated until after the monetary recovery was determined, and Lead Counsel who negotiated the Settlement made declarations to the District Court stating that Cendant was explicitly told that the money it paid into the Settlement would not be decreased in any way as an exchange for implementing the corporate governance changes.

Cendant's general counsel confirmed this declaration, and stated that Cendant did not request or receive any concessions, economic or otherwise, in exchange for adopting the corporate governance changes. Thus, Lead Plaintiff submits that we should leave intact the District Court's factual finding that "Throenle's objection regarding the corporate governance changes has no substance. There has not been the slightest indication that the cash portion of the settlement was related to, dependent upon, or intertwined with the governance proposals." 109 F. Supp. 2d at 252.

Second, Cendant had another possible motivation for agreeing to the corporate governance changes: corporations that have admitted to fraudulent activity can have a hard time attracting and keeping investors unless they make some affirmative efforts to ensure that such fraud will not occur again. It is entirely plausible that Cendant agreed to the

corporate governance changes as a way to show investors that it was addressing the situation that allowed the fraud to occur in the first place, thus trying to make itself more attractive. This possibility counters Throenle's "you don't get something for nothing" argument, because, under this scenario, Cendant gave up the corporate changes in order to encourage continued investment, particularly from institutional investors. In sum, the lawyers involved in negotiating the Settlement have provided affidavits and declarations to the effect that there was no settlement-money-for-corporate-governance-changes exchange, and Throenle offers no evidence otherwise. We are satisfied that the District Court's factual finding that there was no evidence of such an exchange is not clearly erroneous, and we reject Throenle's arguments based on the supposed existence of such an exchange. For all the foregoing reasons, we conclude that Throenle's conflict of interest arguments are not a sufficient basis for concluding that the District Court abused its discretion in approving the Settlement.[26]

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26. Throenle makes two other arguments which can be dealt with summarily. First, she argues that the Settlement Notice was inadequate because it omitted information that the PSLRA requires in such notices, in 15 U.S.C. § 78u-4(a)(7)(B)(ii). That statute provides, in relevant part: "Disagreement on amount of damages: If the parties do not agree on the average amount of damages per share that would be recoverable if the plaintiff prevailed on each claim alleged under this chapter, a statement from each settling party concerning the issue or issues on which the parties disagree" must be included in the notice of a settlement. Throenle appears to interpret this as a requirement that, if the parties do not agree on damages, the notice of a settlement must include a statement from each settling party concerning *every* issue on which the parties disagree. The

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District Court rejected this argument, holding that (7)(B)(ii) clearly only requires a statement on the *damages* issues on which the parties disagree. The District Court was correct. Quite obviously, the phrase "the issue or issues on which the parties disagree" in (7)(B)(ii) refers only to damages issues, not to *every* disputed issue involved in the class action. The court found that the Settlement Notice contained a statement of the damages issues on which the parties disagree and that this statement was sufficient; this finding was supported. Throenle also argues that several of the statements contained in the Settlement Notice were misleading or incomplete; these arguments are patently without merit and we reject them without further discussion.

Second, Throenle argues that the District Court erred in approving the part of the Settlement in which "Lead Plaintiffs have traded their solid case against E&Y" for a 50% interest in any recovery that Cendant gets in its cross-claim against E&Y, because: (1) "Lead Plaintiffs cannot cede their responsibility for prosecuting a class action against one defendant in a case to another defendant in the case," as this violates the "spirit" of Rule 23; and (2) "Cendant's case against E&Y is much weaker than the case brought against E&Y by the class." Throenle's Opening Br. at 57-58. Throenle's argument here involves a mischaracterization of the terms of the Settlement. Under the Settlement, E&Y paid the Class $335 million in return for the Class releasing its claims against E&Y; this is the extent of what the Classis getting from E&Y. Independent of any of the Class's claims, Cendant has asserted certain cross-claims against E&Y. In addition to its $2.85 billion payment, Cendant agreed to give 50% of any recovery of these claims against E&Y to the Class. Cendant is prosecuting not the Class's claims against E&Y but its own cross-claims, so Cendant is not in any way taking over the role of Lead Plaintiff. Consequently, the relative strength of Cendant's claims against E&Y as compared to the Class's claims against E&Y is immaterial to the fairness of this settlement provision; the Class did

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2. Mark's Arguments

Mark attacks the Settlement's Plan of Allocation, arguing that class members who had § 11 claims under the Amended Complaint (i.e., class members who received Cendant stock via the HFS merger) should be allocated higher settlement payments than class members with only § 10(b) claims, because § 11 claims and damages are far easier to prove than § 10(b) claims and damages. She then asserts that Lead Plaintiff did not press for a greater recovery for § 11 claimants because it used the greater strength of the § 11 claims to recover more for the Class's § 10(b) claims.[27] Mark therefore argues that the District Court abused its discretion in approving

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not give up any part of its claims against E&Y for this 50% of Cendant's recovery, but only gave up some portion of its claims against *Cendant* in return for this 50% from Cendant (and given that Cendant paid the Class $2.85 billion, it is not clear that the Class gave up very much for this 50% recovery). Therefore, we reject Throenle's argument that the District Court abused its discretion in approving this portion of the Settlement.

27. As we noted above, the Plan of Alloeation allowed class members with § 11 claims to calculate their damages either under a statutory § 11 calculation or under the plan's § 10(b) calculation, whichever was higher. This is because any § 11 claim can also be treated as a § 10(b) claim, so anyone with a § 11 claim also has a § 10(b) claim (of course, the converse is not true). However, certain class members had both a § 11 claim and an *independent* § 10(b) claim; that is, they received shares in the HFS merger (the § 11 claim), and they also bought shares on the open market (the § 10(b) claim). The Lead Plaintiff had both § 11 claims and independent § 10(b) claims, as did Mark.

the Plan of Allocation, and she asks us to vacate that part of the Settlement. She also asks us to appoint her lead plaintiff, and her counsel as lead counsel, for a subclass composed of the class members with § 11 claims.

Mark cites three basic legal differences between § 10(b) and § 11 claims that affect their relative legal difficulty. First, § 11 claims are strict liability claims (all one needs to establish on the part of the defendant is an untrue statement of material fact in a registration statement) while § 10(b) claims require proof of scienter on the part of the defendant. Second, this difference in the required mental state means that § 11 claims are less fact intensive than § 10(b) claims, with the result that a § 11 claim is much more likely to survive a defendant's motion for summary judgment. Third, there is no proportionate liability under § 11 claims, while there is under § 10(b) if the defendant acted only with recklessness, not knowledge. According to Mark, these three differences make the plaintiff's task of proving her case easier with a § 11 claim than with a § 10(b) claim, thus making the former a more valuable type of claim.

Mark contends that the conflict between the class members with § 11 claims and those without such claims was exacerbated here because Lead Plaintiff used the stronger § 11 claims as leverage to get more recovery for the § 10(b) claims. More specifically, Mark points to the fact that, early in the litigation, Lead Plaintiff agreed to defer a motion for partial summary judgment on its § 11 claims in return for Cendant's agreement to permit informal discovery on the § 10(b) claims. Thus, Mark argues that, in return for benefit for the § 10(b) claims (discovery), Lead Plaintiff sacrificed

leverage for the § 11 claims — the summary judgment motion — which she submits could have resulted in an early determination of liability against Cendant.

Finally, Mark points to two other Cendant cases as evidence that § 11 claims against Cendant are easier to prevail on and thus should result in a higher recovery percentage than the 36% this Settlement provides: the PRIDES settlement, *In re Cendant Corp. PRIDES Litig.*, 51 F. Supp. 2d 537 (D.N.J. 1999), and the Yeager litigation, *Yeager v. Cendant*, 109 F. Supp. 2d 225 (D.N.J. 2000). Mark contends that these cases show that "an unconflicted Plaintiff with a particularly strong § 11 Claim" against Cendant can recover close to 100% of her damages, much higher than the 36% return this Settlement garnered. Under the terms of the PRIDES settlement, members of the class received almost 100% of their damages claims. In *Yeager*, the district court granted partial summary judgment in favor of the plaintiff on the issue of liability on his § 11 claims, while denying summary judgment on § 10(b) liability because there was a genuine issue of material fact as to Cendant's scienter.

Mark's arguments are not without force. However, there are several considerations that convince us that the District Court did not abuse its discretion in approving the Plan of Allocation. First, the difference in the liability standards between § 11 and § 10(b) claims ultimately does not make a substantial difference in this case, as it is basically undisputed that Cendant's employees committed fraud, so the necessary scienter for the § 10(b) claims has been admitted. It is true that there is a possible issue of proportionate liability that arises with the § 10(b) claims, because Cendant has stated

that it would raise the defense that the scienter of its employees cannot be attributed to Cendant itself. However, as we noted previously, *see supra* Part III.A.4, based on the record before us we think that Cendant would have a very difficult time making out this defense.

Second, the real difficulty in the trial of this case would have been establishing damages, a process which both § 10(b) and § 11 claimants would have to undergo equally and which almost certainly would devolve into a "battle of the experts." Although § 11 claimants could at the outset calculate their damages rather simply (by subtracting the price of the stock at the time the lawsuit was brought from the amount that they paid for the stock, *see* 15 U.S.C. § 77k(e)), the defendant can counter this calculation by showing that any or all of this difference in stock price was caused by something other than the fraud, *see id.* Thus, on a § 11 claim there would still be a "battle of the damage experts;" the only difference between a § 11 and a § 10(b) damage determination in this case is that, on a § 11 claim, the defendant would bear the burden of disproving the plaintiff's straightforward subtraction calculation. In fact, in *Yeager*, the district court denied Yeager summary judgment on his § 11 claim in part because the court found that there was a genuine issue of material fact as to the amount of Yeager's § 11 damages. *See Yeager*, 109 F. Supp. 2d at 229. Furthermore, the informal discovery that Lead Plaintiff obtained in return for deferring the summary judgment motion produced information relevant to determining the Class's damages, which was beneficial to both the § 11 and § 10(b) claims.

Finally, it is also important to note that the § 10(b) damages available to the class members in this case are generally greater than the § 11 damages available, so that in this respect the § 10(b) claims are potentially stronger than the § 11 claims.[28] At all events and for all these reasons, we are chary of holding that the respective legal strengths of the § 10(b) and § 11 claims involved here should have been factored into the fairness of the settlement determination. This would be a speculative enterprise at best, and the differences in strength of these claims are not so great as to make the outcome of this process clear.

Furthermore, the *PRIDES* settlement and the *Yeager* litigation are distinguishable. The *PRIDES* settlement involved

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28. The reason for this is that § 11 damages and § 10(b) damages are calculated under the Plan of Allocation using different days as the "selling date," i.e., the date on which the class member is deemed to have sold her Cendant stock for damage determination purposes. As we described, *supra* n.8, § 11 damages are determined by using as a selling date the date lawsuits were first filed (April 16, 1998). Section 10(b) damages, however, are determined using the earlier of (1) the date the class member actually sold her stock or (2) the last day of the class period, i.e., August 28, 1998. Thus, because a class member would have no damages if she sold before April 16, 1998 (the fraud was not revealed until after trading on April 15, 1998, so sales before then got the full benefit of the fraudulently inflated price of Cendant's stock), damages on the § 10(b) claims are determined using a date between April 16, 1998 and August 28, 1998. Because Cendant stock declined steadily between April 16 and August 28, 1998, the calculations of § 10(b) damages under the Plan of Allocation (which may use a post-April 16 date as the selling date) are generally more than § 11 damage calculations under the plan (using April 16 as the selling date).

a paper payout rather than a cash payout (i.e., the plaintiffs got new Cendant stock for their old stock), *see Cendant PRIDES*, 51 F. Supp. 2d at 540, while the case at bar involves a cash payout.[29] Second, *PRIDES* was a "claims made" settlement, with unclaimed settlement funds reverting back to Cendant, *see id.* at 541; here all the settlement cash (and interest) will go to the Class. This point is important because it means that unmade claims in this Settlement will increase the percentage return for each class member, while unmade claims in the *PRIDES* settlement did not increase each class member's return but instead decreased the amount that Cendant had to pay out. Put another way, giving 36% recovery to 100% of the class in a standard settlement like the case at bar is equivalent (in terms of money paid out by the defendant) to giving 100% recovery in a claims made settlement if only 36% of the class actually makes claims (assuming that each claim is for the same amount).

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29. Mark argues that, although the *PRIDES* settlement involved a "paper for paper" exchange, a *PRIDES* plaintiff who sold her new Cendant stock within the first ten days that she was able to received almost 100% of her damages claimed, so that the *PRIDES* settlement effectively involved a nearly 100% cash payout. However, at the time when the *PRIDES* settlement was reached, there was no guarantee that the class members would garner such a steadily high return over the first few days during which they would be able to sell their stock. There was about a nine-month delay between the settlement approval and the date when the class members could sell their new shares in the market, and much could have happened to Cendant and its stock during that interim that could have affected the amount of return that the *PRIDES* plaintiffs received. Thus, the *PRIDES* "paper for paper" exchange involved a sizeable risk, at the time the settlement was entered into, of a payout substantially less than 100% of the class's damages.

Thus, the "claims made" nature of the *PRIDES* settlement meant that Cendant could agree to a settlement in that case that gave a much higher percentage recovery to all potential class members, because it knew that it only had to pay out to those class members who actually made claims, which was certain to be a subset of the entire class. Not only does this mean that *PRIDES* is not "really" a settlement for 100% recovery (because less than 100% of the potential claimants will make a claim, thus lowering the amount Cendant must pay out), it also means that the settlement in this case is not "really" a settlement for 36% recovery (because less than 100% of the potential claimants will make a claim, thus raising the amount each claimant will receive). More specifically, at the time of oral argument in this case, $4.962 billion in claims had been submitted to the Claims Administrator, which translates into a 67% recovery for each class member — almost double the original 36% recovery figure.[30]

As for *Yeager*, that case was not a class action (the plaintiff had opted out of this Class) and was for far less in damages, so any comparisons between *Yeager* and this case are flawed at best. Furthermore, as we note above, the district court partially denied Yeager summary judgment on his § 11 claims because there was a genuine issue of material fact as to the amount of damages.

For the foregoing reasons, we reject Mark's arguments and conclude that the District Court did not abuse its discretion by approving a settlement that treated § 10(b) and § 11 claims more or less equally.

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30. The deadline to submit claims to the Claims Administrator was October 31, 2000.

C. The Davidsons' Objections

For the reasons set forth *supra* at note 10, it is not clear at this juncture whether the Davidsons are members of the Class. If this Court, in its en banc sitting in November, 2001, decides that the Davidsons are included in the Class, we would be required to pass on the issues they raise in this appeal. Given the proliferation of appeals in this case (this being the seventh appeal in the *Cendant* proceedings *see supra* n.11), and the importance of bringing this matter to a close as soon as the issues presently unsettled are resolved, we think it prudent to address those issues now. Because these objections do not warrant extensive treatment, we will dispose of them in relatively short order.

1. Class Certification Findings

The Davidsons first argue that the District Court erred by failing to make explicit findings that all of Federal Rule of Civil Procedure 23's requirements were met when certifying the Class. They argue further that the court erred by not making those findings again at the settlement stage. In the Davidsons' submission, if the court had made the Rule 23 findings, it never would have certified the Class as it now stands; rather it would have at least certified a subclass for merger claimants like them. In particular, the Davidsons argue that, if it had done its job properly, the court would have (or should have) found that Rule 23(a)'s requirements of typicality and adequate representation were not met by the Class as it was defined and by the Lead Plaintiffs' representation. In their Reply Brief, the Davidsons add the argument that Rule 23(a)'s commonality requirement was not met as well.

However, the Davidsons neglected to raise these arguments in a timely fashion, failing to raise them until the settlement approval stage. We thus conclude that they waived these arguments by not raising them earlier. *See Joel A. v. Giuliani*, 218 F.3d 132, 140 (2d Cir. 2000) (holding that objectors to a class action settlement who argued, at the settlement approval stage, that the Rule 23 requirements were not met for them in their subclass were untimely with their objection, and thus the objection was waived).

2. Notice of the Settlement

The Davidsons contend that the Settlement Notice given to the class members was insufficient, in that it did not give them sufficient information to make an informed decision whether to opt out before the opt-out deadline. They argue that the relevant terms of the Settlement Agreement — the Plan of Allocation and the scope of the claims against Cendant that were released — were not disclosed before the opt-out period ended. This defect, they assert, made the notice that was sent to the Class insufficient. The Davidsons submit that the court either should have sent out another notice with this particular information about the terms of the Settlement before the opt-out deadline, or should have extended the opt-out deadline (or provided for a new opt-out period) beyond the time that the terms of the Settlement were released. The Davidsons argue that the reaching of a settlement in effect made this class action a settlement class action, so that the notice requirements for a settlement class action set forth in *GM Trucks*, 55 F.3d 768, 792 (3d Cir. 1995), apply here. We disagree.

This was not a settlement class action but a previously certified class action that settled. The Davidsons have provided no authority for their contention that if settlement is reached before the opt-out period has run the specific terms of the settlement must be sent to the class before the end of the opt-out period, or that reaching a settlement requires a new opt-out period. We do not think the requirements of Rule 23 mandate these measures, and thus reject the Davidsons' arguments.

3. Intra-Class Conflicts

The Davidsons press an interesting argument based on the conflicts that allegedly arose within the Class when the Settlement precluded the § 11 claims and 1933 Act § 12 claims[31] [hereinafter "§ 12 claims"] of class members who acquired CUC shares via non-HFS mergers with CUC, even though the Settlement did not provide any recovery for these § 11 and § 12 claims. The Davidsons contend that the District Court abused its discretion and that the Lead Plaintiff breached its duty to the Class when they accepted and approved a settlement with such terms. Relatedly, the Davidsons contend that an intra-class conflict arose because the Settlement gave HFS merger claimants a choice between calculating their recoveries as § 10(b) or § 11 damages, while non-HFS merger claimants were given no such choice.

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31. Section 12 of the Securities Act of 1933 provides for civil liability for anyone who offers or sells a security "by means of a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading . . . ." 15 U.S.C. § 77l.

Appendix A

As we understand it, the premises of the Davidsons' argument are that:

(1) The Amended Complaint did not include any § 11 and § 12 claims against Cendant for class members who received Cendant stock from any merger other than the HFS merger;

(2) The Davidsons and other merger partners of Cendant/CUC during the class period have potential § 11 and § 12 claims against Cendant;

(3) These potential § 11 and § 12 claims against Cendant could produce greater damages than a corresponding § 10(b) claim against Cendant;

(4) The Settlement does not allow the Davidsons or other non-HFS merger class members to recover on their § 11 or § 12 claims; under the Plan of Allocation, they are limited to recovering under § 10(b) for their losses; and

(5) The Settlement precludes non-HFS merger class members like the Davidsons from bringing their § 11 and § 12 claims against Cendant in the future.

On the basis of the foregoing, the Davidsons reason that the Settlement was unfair because: (i) it prevented non-HFS merger class members from recovering on their § 11 and § 12 claims while precluding these class members from bringing those claims in the future, and (ii) it treated the HFS merger claimants specially, by allowing them to recover the higher of their damages calculated under § 10(b) and under

§ 11, while denying the non-HFS merger class members the same opportunity.

Again, we disagree. If the Davidsons are arguing that their § 11 and § 12 claims should have been included in the Amended Complaint in the first place, they waived this claim by not bringing it earlier. *See Joel A. v. Giuliani*, 218 F.3d 132, 140 (2d Cir. 2000). Furthermore, regarding the claim that an intra-class conflict arose from the special treatment given the HFS claimants, we reject a fundamental premise of the Davidsons' above argument, namely (3): that the Davidsons' § 11 claims could produce greater damages than their corresponding § 10(b) claims. The Davidsons' § 11 claims would have to be determined under the relevant section of the 1933 Securities Act by using the date of the filing of this lawsuit. *See supra* n.8. However, using that date, the Davidsons' potential § 11 damages as we calculate them are *less* than the § 10(b) damages that they are allotted under the Plan of Allocation. Thus, the Davidsons are not prejudiced by being limited to only § 10(b) damages under the terms of the Settlement — those damages are greater than any § 11 damages they would have received under the Plan of Allocation — so there is no unfairness or intra-class conflict here.

4. Alleged Flaws in the Plan of Allocation

The Davidsons submit that the District Court abused its discretion in approving the Settlement's Plan of Allocation because the Plan "was based upon clearly erroneous premises." They contend that the Plan does not correctly determine out-of-pocket damages for the § 10(b) claims

because it does not correctly define the "true value" of Cendant stock when it was purchased by the class members, as it uses figures that "pool" Cendant's finances with companies that Cendant merged with. Concomitantly, the Davidsons argue that the Lead Plaintiff did not establish a proper evidentiary basis for the Plan's method of determining damages.

It is clear from the record that the District Court was faced with competing expert opinions on the proper way to determine and allocate damages. The record shows that the court carefully considered the expert advice, and then chose to accept the plan submitted by the Lead Plaintiff's damages expert over the plan submitted by the Davidsons' expert. This kind of decision is intensely fact-based, falling within the purview of the District Court's discretion. The District Court properly based its decision on evidence offered by the Lead Plaintiff, which provided more than a sufficient evidentiary basis for its decision. *See, e.g.*, Bradford Cornell & R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 U.C.L.A. L. Rev. 883 (1990) (presenting the damages study on which the Plan of Allocation was based); *In re California Micro Devices Securities Litig.*, 965 F. Supp. 1327 (N.D. Cal. 1997) (using the same method of allocating maximum artificial inflation over the class period, developed by David L. Ross of Lexicon, Inc., as was used here). We therefore find no abuse of the court's discretion in its decision to accept the Plan of Allocation.

Accordingly, the Davidsons' objections are rejected.

Appendix A

IV. Counsel Selection and Counsel Fees

We turn to the issues involving the selection of lead counsel and the determination of its fee. The Reform Act establishes detailed and interrelated procedures for choosing a lead plaintiff and selecting lead counsel. We first address the District Court's appointment of the CalPERS Group as lead plaintiff, and then its choice to use an auction to select lead counsel. With respect to legal questions — including whether the District Court applied the correct standards in selecting the lead plaintiff and when, if ever, a court may hold an auction to select lead counsel in cases governed by the PSLRA — we review de novo. *See Brytus v. Spang & Co.*, 203 F.3d 238, 244 (3d Cir. 2000). If the court committed no legal errors, we review its award of attorneys fees for abuse of discretion. *See id.*

A. Introduction: Attorney-Client Tension in the Class Action Context

Lawyers operate under ethical rules that require them to serve only their clients' interests. When a representation involves a single client, the ability to select, retain, and monitor counsel gives clients reason to be confident that their lawyers will live up to this obligation. The power to select counsel lets clients choose lawyers with whom they are comfortable and in whose ability and integrity they have confidence. The power to negotiate the terms under which counsel is retained confers upon clients the ability to craft fee agreements that promise to hold down lawyers' fees and that work to align their lawyers' economic interests with their own. And the power to monitor lawyers' performance and to

communicate concerns allows clients to police their lawyers' conduct and thus prevent shirking. This regime has served the American legal system well for a very long time.

1. The Problem With Class Actions

Most of the safeguards we have described vanish in the class action context, where "the client" is a sizeable, often far-flung, group. Logistical and coordination problems invariably preclude class members from meeting and agreeing on anything, and, at all events, most class members generally lack the economic incentive or sophistication to take an active role. There is simply no way for "the class" to select, retain, or monitor counsel.

Although class counsel has an ethical duty of undivided loyalty to the interests of the class, reason for concern remains. This is in large measure because a rational, self-interested client seeks to maximize net recovery; he or she wants the representation to terminate when his or her gross recovery minus his or her counsel's fee is largest. In contrast, at least in theory and often in practice, a rational, self-interested lawyer looks to maximize his or her net fee, and thus wants the representation to end at the moment where the difference between his or her fees and costs — which include not only the money that the lawyer spends in advancing his or her client's cause but also the opportunities for other work that the lawyer gives up by pursuing it — is greatest. These two points rarely converge. As a result, there is often a conflict between the economic interests of clients and their lawyers, and this fact creates reason to fear that class counsel will be highly imperfect agents for the class.

Because of this conflict (and because "the class" cannot counteract its effects via counsel selection, retention, and monitoring), an agent must be located to oversee the relationship between the class and its lawyers. Traditionally, that agent has been the court. Although some courts have played an active role with regard to selecting lead counsel in securities cases, most have traditionally appointed the person who filed the first suit as lead plaintiff, and generally selected that person's lawyer to serve as lead counsel (assuming, of course, that the lawyer possessed sufficient competence and experience). *See, e.g.*, H.R. Conf. Rep. 104-369, at 33 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 732. In addition, time and institutional constraints have generally prevented courts from actively monitoring the performance of lead counsel during the pendency of litigation.

Under such a regime, it was essential for courts to scrutinize fee requests to protect the interests of absent class members. Lead plaintiffs were often unsophisticated investors who held small claims, and, according to some reports, they were sometimes paid "bounties" by lead counsel in exchange for their "services." *See id.* In such situations, it was unlikely that the lead plaintiff had undertaken a meaningful counsel selection process; indeed it was suspected that lead counsel generally selected the lead plaintiff rather than vice versa. *See id.* at 32-33, *reprinted in* 1995 U.S.C.C.A.N. 730, 731-32; S. Rep. No. 104-98, at 6 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 685. Moreover, there was generally little reason to believe that the lead plaintiff had the incentive or inclination to engage in aggressive or effective bargaining over lead counsel's fee, or that a typical lead plaintiff could be counted on to engage in meaningful monitoring of lead counsel's performance.

2. The Evolution of Judicial Review of Counsel Fees In Class Actions

Courts have developed several means of reviewing the reasonableness of fee requests. At the dawn of the class action era, the most frequently used device was the lodestar method, which was developed by this Court in *Lindy Brothers Builders, Inc. of Philadelphia v. American Radiator & Standard Sanitary Corp.*, 487 F.2d 161 (3d Cir. 1973). Under that approach, the court assesses the number of hours that lead counsel reasonably worked, decides the reasonable hourly rate for the lawyers' services, and determines counsel's fee by multiplying the number of hours reasonably worked by the reasonable hourly rate. The Supreme Court has developed an elaborate jurisprudence covering the proper application of the lodestar method, which remains the governing approach for cases governed by fee-shifting statutes. *See, e.g.*, *Hensley v. Eckerhart*, 461 U.S. 424 (1983); *Blum v. Stenson*, 465 U.S. 886 (1984); *Webb v. Board of Educ. of Dyer County*, 471 U.S. 234 (1985); *City of Riverside v. Rivera*, 477 U.S. 561 (1986); *Pennsylvania v. Delaware Valley Citizens' Council for Clean Air*, 483 U.S. 711 (1987); *Blanchard v. Bergeron*, 489 U.S. 87 (1989); *Farrar v. Hobby*, 506 U.S. 103 (1992).

Over time, criticism mounted against using the lodestar method, especially in "common fund" cases such as this one. The "common-fund doctrine . . . allows a person who maintains a lawsuit that results in the creation, preservation, or increase of a fund in which others have a common interest[ ] to be reimbursed from that fund for litigation expenses incurred." Report of the Third Circuit Task Force,

Court Awarded Attorney Fees, 108 F.R.D. 237, 241 (1985) [hereinafter "1985 Task Force Report"]. In common fund cases the fees paid to class counsel come directly out of the recovery of the class, as opposed to statutory fee-shifting cases where the plaintiffs' recovery and counsel's fees are distinct. In those situations, every additional dollar given to class counsel means one less dollar for the class, regardless how a total settlement package is formally structured. *Cf. GM Trucks*, 55 F.3d at 821 ("[P]rivate agreements to structure artificially separated fee and settlement arrangements cannot transform what is in economic reality a common fund situation into a statutory fee shifting case.")

As the 1985 Task Force Report recognized, using the lodestar method in the common fund context creates numerous problems. First, because the lodestar compensates lawyers based on hours worked rather than results achieved, there is a risk that it will cause lawyers to work excessive hours, inflate their hourly rate, or decline beneficial settlement offers that are made early in litigation. *See* 1985 Task Force Report, 108 F.R.D. at 247-48. Second, requiring courts to decide how many hours a lawyer "reasonably" worked in pursuing a given matter requires an enormous investment of judicial time. *See id.* at 246. Third, though creating the illusion of mathematical precision, the lodestar method can be quite subjective and can produce wildly varying awards in otherwise similar cases. *See id.* at 246-47.

In light of these criticisms, the 1985 Task Force Report recommended a different device for setting attorneys fees in common fund class actions: the percentage-of-recovery method. *See id.* at 255. This Court has generally accepted

that recommendation. *See, e.g., In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 148 F.3d 283, 333-34 (3d Cir. 1998). Under the percentage-of-recovery approach, a court charged with determining whether a particular fee is "reasonable" first calculates the percentage of the total recovery that the proposal would allocate to attorneys fees by dividing the amount of the requested fee by the total amount paid out by the defendant; it then inquires whether that percentage is appropriate based on the circumstances of the case. In making that decision, this Court has directed district courts to consider numerous factors, as well as recommending that they employ a lodestar "cross-check." *See, e.g., In re Cendant Corp. PRIDES Litig.*, 243 F.3d 722, 733-35 (3d Cir. 2001).[32]

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32. For a sampling of the literature assessing the desirability and efficacy of using the percentage-of-recovery method in common fund cases, see, for example, Reagan W. Silber & Frank E. Goodrich, *Common Funds and Common Problems: Fee Objections and Class Counsel's Response*, 17 Rev. Litig. 525 (1998) (arguing in favor of the use of the percentage-of-recovery method in common fund cases, and contending that the percentage allocated to counsel fees should not decrease simply because the size of the fund increases); William J. Lynk, *The Courts and the Plaintiffs' Bar: Awarding the Attorney's Fees in Class Action Litigation*, 23 J. Legal Stud. 185 (1994) (employing economic analysis to consider the similarities and differences between the lodestar and percentage-of-recovery methods, and surveying case law in an effort to determine which method better explains the actual size of class counsel fee awards); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 48-61 (1991) (analyzing and critiquing both methods, arguing that the percentage-of-recovery method, though preferable to the lodestar, is deeply

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The 1985 Task Force Report also identified another problem with the traditional approach: the fact that fees and their method of calculation were generally not set until the conclusion of litigation. This reality was troubling for a several reasons. First, it required the court to assess the reasonableness and efficacy of counsel's efforts in hindsight, with all of the risks of distortion and bias associated with this kind of decision-making. Second, it meant that attorneys had to litigate an entire case before finding out what hours or actions the court would consider "reasonable." Third, waiting until the end to set fee terms eliminated any potential for those terms to align the incentives of the class and its lawyers during the pendency of the litigation. The Task Force Report recommended that courts "attempt to establish a percentage fee arrangement agreeable to the Bench and to plaintiff's counsel . . . at the earliest practicable moment." 108 F.R.D. at 255.[33]

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flawed as well); Monique LaPointe, Note, *Attorney's Fees in Common Fund Actions*, 59 Fordham L. Rev. 843 (1991) (assessing both methods and arguing that the most important thing for courts to do is to pick one or the other in order to facilitate case management and promote predictability).

33. The Task Force members disagreed among themselves as to how early was appropriate. Some pushed for as early a time as possible, suggesting after the pleadings have been filed but before discovery was significantly underway. Other (judicial) members of the Task Force preferred a later point to allow them to have a "feel" for how the case had developed. *See id.* at 255 n.62. The members of the Task Force also disagreed as to whether a "time limit should be imposed on the court's ability to shift from one fee regime to another." (Cont'd)

Appendix A

The 1985 Task Force Report recognized that it would be problematic to have the presiding judge set a fee award at the outset of a case. *See id.* at 256. One cannot develop a fee scale without making an assessment of the likelihood of success and the size of the recovery. But requiring the court to make (and act upon) an assessment of the strength of a plaintiff class's case early in litigation was thought to be in tension with the need for judges to be objective. Although the Task Force Report proposed a process for up-front fee negotiation through a court-appointed, non-judicial representative, it does not appear to have been taken up by any court.[34]

The Task Force Report's recommendations contained no suggestions for changes in the areas of counsel selection and

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Id. at 257. Some of the judicial members of the Task Force thought that no such limit should apply so as to preserve the court's ability to protect the best interests of the class. *See id.* Other members of the Task Force believed that giving the court that degree of discretion would "destroy[ ] the predictability" that advance negotiation is intended to achieve. *Id.*

34. The Task Force Report recommended that "the court appoint a non-judicial representative — who typically will be an attorney — for the then putative fund beneficiaries, who will negotiate the agreement in the usual marketplace manner and submit the proposal for the court's approval." *Id.* The Report contemplated that the court's review of the agreement negotiated between court-appointed intermediary and counsel would be "completely independent and thorough," and that the court would have the power to "accept, reject, or revise the arrangement, either providing exact terms or merely establishing ranges and retaining the ultimate authority to revise the agreement if later circumstances warrant." *Id.* at 257.

counsel monitoring. The first major attempt to address counsel selection as well as fees came in Judge Vaughn R. Walker's application of the auction technique in *In re Oracle Securities Litigation*, 131 F.R.D. 688 (N.D. Cal. 1990), which has since been used in a number of cases that are listed in the margin.[35] The basic concept is simple: the judge solicits bids from law firms to serve as lead counsel and selects the lowest bidder that the court determines will adequately represent the class. In theory, an auction will mimic a market transaction and result in reasonable quality, low-cost representation for the class.[36]

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35. We have located eleven cases besides this one and *Oracle* where a district court selected class counsel by means of an auction. Two were antitrust cases. *See In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190 (N.D. Ill. 1996) (Shadur, J.); *In re Auction Houses Antitrust Litig.*, 197 F.R.D. 71 (S.D.N.Y. 2000) (Kaplan, J.). One was a securities class action not governed by the PSLRA. *See In re Wells Fargo Sec. Litig.*, 156 F.R.D. 223 (N.D. Cal. 1994) (Walker, J.). And eight were securities class actions governed by the Reform Act. *See Raftery v. Mercury Fin. Co.*, No. 97 C 624, 1997 WL 529553 (N.D. Ill. 1997) (Lefkow, J.); *Sherleigh Assoc. LLC v. Windmere-Durable Holdings, Inc.*, 184 F.R.D. 688 (S.D. Fla. 1999) (Lenard, J.); *Wenderhold v. Cylink Corp.*, 188 F.R.D. 577 (N.D. Cal. 1999) (Walker, J.); *In re Lucent Tech., Inc. Sec. Litig.*, 194 F.R.D. 137 (D.N.J. 2000) (Lechner, J.); *In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780 (N.D. Ill. 2000) (Shadur, J.); *In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951 (N.D. Ill. 2001) (Shadur, J.); *In re Quintus Sec. Litig.*, No. C-00-4263 (N.D. Cal., April 12, 2001) (Walker, J.); *see also In re Network Assocs., Inc. Sec. Litig.*, 76 F. Supp. 2d 1017 (N.D. Cal. 1999) (Alsup, J.) (directing the lead plaintiff to undertake an auction process).

36. On January 30, 2001, the opinion author, acting as Chief Circuit Judge and Presiding Officer of the Third Circuit Judicial (Cont'd)

The auction method offers several potential advantages. First, unlike all of the methods previously discussed, it deals with counsel selection in addition to counsel retention. When an auction is used, counsel are no longer "selected" by the race-to-the-courthouse method, and this means that courts

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Council, announced the formation of a Task Force on the Selection of Class Counsel whose primary duty is to assess the propriety and efficacy of the use of the auction method in its various applications, and to formulate recommendations for the bench, bar, and public. The Press Release containing this announcement is available at: http://www.ca3.uscourts.gov/classcounsel/taskforce.pdf. Other press releases relating to the 2001 Task Force, a list of questions that it is addressing, witness statements, and transcripts of the proceedings so far are all available at: http://www.ca3.uscourts.gov/classcounsel/public.htm. The 2001 Task Force's preliminary report will be made public in October 2001, and its final report is scheduled for release sometime during the Spring of 2002.

Judge Ambro, named in January as a member of the 2001 Task Force, later became a member of this panel through the Court's random assignment process. Judge Becker informed counsel for all parties of this fact during a conference call that was held prior to oral argument, and no party objected to Judge Ambro's continued involvement in this matter. During this call, Judge Becker also "explained that everything that is before the Task Force — written presentations, case law, and transcripts of oral presentations, et alia, ha[d] been placed on the Third Circuit website (www.ca3.uscourts.gov), available through a link entitled 'Class Counsel Information.' " *In re Cendant Corp. Litig.*, No. 00-2520 (3d Cir., May 15, 2001) (unpublished order). Lastly, Judge Becker stressed that "the function of the Task Force is limited to making general recommendations to the bench and bar at large (throughout the nation)" and that its recommendations would have "no precedential effect in any circuit." *Id.*

can exercise greater control over counsel quality. Second, auctions may lead to lower-priced representation. Under the traditional method, lead counsel (who has already been appointed) tries to get as much as it can from the court in terms of fees. Under the auction method, in contrast, prospective lead counsel compete to submit the lowest reasonable bid.[37] Third, assuming a sufficiently large number of bidders, an auction will likely better approximate a market transaction than having a judge set attorneys fees after the fact. Fourth, auctions may provide a way for new firms to enter the market for plaintiff-side securities class action lawyers, thus rendering the overall market more competitive.[38] Fifth, the auction method may require a smaller investment of judicial time than the time-consuming lodestar method, and could minimize the dangers of hindsight biases associated with the traditional, after-the-fact approach to determining fees. This Court has recognized the potential benefits of the

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37. *See, e.g.*, Proceedings of the 2001 Third Circuit Task Force on the Selection of Class Counsel [hereinafter "2001 Task Force Proceedings"], Statement of the Committee on Federal Courts of the Association of the Bar of the City of New York, at 4-5, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/struve.pdf [hereinafter "NYC Bar Association"]; 2001 Task Force Proceedings, Statement of John C. Coffee, Jr., at 2, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/johncoffee.pdf [hereinafter "Coffee"]; 2001 Task Force Proceedings, Statement of Richard B. Drubel, at 4-5, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/Richard_Drubel.pdf [hereinafter "Drubel"]; *see also* discussion, *infra* at n.44 (describing Judge Milton I. Shadur's belief that his use of the auction technique has saved class members in cases before him millions of dollars in counsel fees).

38. *See, e.g.*, Coffee at 2.

auction method, commending it to district courts in this circuit for their consideration as one potential approach to the problems in this area. *See Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 201 n.6 (3d Cir. 2000).[39]

Auctions may not be a panacea, however. One persistent criticism is that courts generally identify the "lowest" bid submitted by an "adequate" bidder and appoint that bidder as lead counsel, without performing the cost/quality weighing in the way that a real client would.[40] Another fear is that because auctions do not reward the attorneys who discover legal violations, they may reduce lawyers' incentives to seek out and disclose illegality (because unless they are selected as lead counsel, they may not be compensated for the time they spent doing so).[41] Moreover, bids in large, potentially

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39. In *Gunter* this Court noted the auction technique "appears to have worked well," and identified the decision now here on review, among others, as cases where it had been used. *See id.* at 201 n.6. *Gunter* was an antitrust case, hence questions involving the compatibility of the auction procedure with the Reform Act were not before the Court. Moreover, this type of citation to a district court opinion, offered to open eyes to a range of possibilities, was not even dicta, and, at all events, does not preclude a subsequent panel from reviewing the merits of a district court's decision.

40. *See, e.g.*, 2001 Task Force Proceedings, Statement of Lucian Ayre Bebchuk, at 6-8, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/Bebchuk.Statement.pdf [hereinafter "Bebchuk"]; Task Force Proceedings, Statement of Jill E. Fisch, at 3-4, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/fisch.pdf [hereinafter "Fisch"].

41. *See, e.g.*, Fisch at 7; NYC Bar Association at 3; Coffee at 3. But *see In re Bank One S'holders Class Actions*, 96 F. Supp. 2d

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high-recovery, cases are likely to be quite complex and it may be difficult for courts to assess their relative costs to the class. This risk is especially strong in cases where the bids consist of a complicated set of alternate fees that vary depending on the size of the recovery and the stage of the proceedings at which the recovery is obtained. In such situations, a court cannot assess which bid is the cheapest without first assessing the likely amount of recovery.[42] Additionally, if there are too few bidders, the degree to which an auction will actually simulate the market is questionable.[43] Finally, there is a risk that auctions could result in a "winner's-curse," systematically selecting bidders who overestimate the odds or amount of a likely recovery. Such a "winning" bidder might then find itself litigating an unprofitable case, which may then give it an incentive to settle early and cheaply.[44] No consensus has yet emerged about the relative efficacy of the auction technique, although Judge Walker and Judge Milton I. Shadur of the United States District Court for the Northern District of Illinois have made a powerful case for it, both in terms of policy and tangible (fee-saving) results.[45]

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780, 789 n.13 (N.D. Ill. 2000) (ordering a lead plaintiff to ensure that the lawyers who prepared the consolidated class action complaint — but were not selected as lead counsel via a court-ordered auction — were compensated for their time).

42. *See, e.g.*, Fisch at 2; NYC Bar Association at 5.

43. *See, e.g.*, Coffee at 3; Fisch at 6-7.

44. *See, e.g.*, Coffee at 3.

45. Along with Judge Walker (who, as we noted in the text, originated the use of the auction method in federal court), Judge
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Shadur has been a leading proponent of the auction method. Judge Shadur held one of the first lead counsel auctions in *In re Amino Acid Lysine Antitrust Litigation*, 918 F. Supp. 1190 (N.D. Ill. 1996), and has since used the technique in two other cases as well. *See In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780 (N.D. Ill. 2000); *In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951 (N.D. Ill., Apr. 12, 2001). In these opinions, Judge Shadur cogently explains why courts have a basic obligation to protect the pecuniary interests of absent class members, persuasively outlines why courts cannot fulfill this duty by relying on decisions made by lead plaintiffs, and powerfully argues in favor of the auction method as the only way to minimize the agency costs that plague relationships between absent class members and class counsel. Judge Shadur believes that his use of the auction technique has saved class members in cases before him millions of dollars in counsel fees. *See, e.g.*, *Bank One*, 96 F. Supp. 2d at 785 n.5 (claiming that the *Lysine* auction saved the class between $5 and 10 million in attorneys fees). In his recent opinion in *In re Comdisco Sec. Litig.*, No. 01 C2110, 01 C 874, 2001 WL 722097 (N.D. Ill. June 27, 2001), Judge Shadur noted that the two prior cases in which he has used the auction technique resulted in attorneys fees of approximately 6% of the class's total recovery, and he contrasted this with a recent case from the Eastern District of Pennsylvania in which counsel was awarded 25% of the total recovery. *See id.* at *5. Based on this, Judge Shadur calculated that his use of the auction method saved plaintiff class members $10 million or more in counsel fees in each of the cases where he has employed it. *See id.* Although Judge Shadur's analysis seems quite persuasive, some have argued that his auctions have resulted in lower overall recoveries as well as lower counsel fees and have thus cost rather than saved class members money, *see, e.g.*, John C. Coffee, Jr., *Securities: Class Actions*, Nat'l L.J., Sept. 14, 1998, at B6 (criticizing the *Lysine* auction on this basis).

We need not engage in a dialogue with Judge Walker and Judge Shadur over the merits and demerits of the auction method in class
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Despite significant differences, it is critical to realize that the traditional approach, the procedure suggested by the 1985 Task Force Report, and the auction method all share two critical traits. First, none of them addresses the inability of the class, a typical lead plaintiff, or the court to monitor lead counsel in an adequate manner. Second, and perhaps more significantly, all three methods rely on the court (or an agent hand-picked by the court) to serve as the class's agent vis-à-vis its counsel. This is less true under the auction method, but even then the court must decide which bidders are "qualified," assess which bids are "adequate," and determine which of the adequate bids submitted by qualified bidders is the "lowest." Another option would be to assign responsibility to a different type of agent. In 1995, two scholars recommended that Congress do just that.

3. The PSLRA

In *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, Professors Elliott J. Weiss and John S. Beckerman argued that institutional investors are well suited to select,

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actions generally at this time, however, because before us is a question of statutory interpretation (of the Reform Act) rather than one of judicial policy. As we explain *infra* at Part IV.C, we think that lead counsel auctions are generally (and that the auction in this case was) inconsistent with the statutory scheme embodied in the Reform Act. It will be left to later opinions of this Court, to the 2001 Task Force, and perhaps to the Congress, to wrestle with the forceful policy arguments in favor of the auction method that Judge Walker and Judge Shadur have advanced.

retain, and monitor lead counsel in securities class actions. *See* 104 Yale L.J. 2053 (1995). Their article explained how then-current practices deterred institutional investors from taking a more active role, and recommended legislation to encourage them to serve as lead plaintiffs.

The Weiss and Beckerman proposal had three parts. First, to ensure that institutional investors found out about pending class actions, they argued that courts should require that meaningful notices be sent out soon after the filing of a complaint. *See id.* at 2108. Second, "because the named plaintiff or group of plaintiffs with the largest financial stake in the outcome of an action has the greatest economic incentive to monitor class counsel's performance effectively," Weiss and Beckerman suggested that courts "adopt a presumption that that plaintiff or group will 'most adequately' represent class members' interests." *Id.* at 2105. They recommended that "[c]ourts . . . provide other putative plaintiffs with an opportunity to rebut this presumption, but should allow them to do so only by demonstrating that the presumptively 'most adequate' plaintiff has a significant disqualifying conflict of interest or is subject to unique defenses that would render it incapable of adequately representing the class." *Id.* at 2105-06. Weiss and Beckerman further suggested that only putative class members should be permitted to file adequacy and typicality objections against the presumptive lead plaintiff, and recommended that even those parties be entitled to discovery "only where they can demonstrate some reasonable basis for believing that a presumptively adequate plaintiff would not be capable of representing the class adequately." *Id.* at 2109.

Third, once such a lead plaintiff was selected, Weiss and Beckerman submitted that courts should "[a]ppoint as lead counsel the attorney for the 'most adequate plaintiff' " and should defer to that plaintiff's discretion in setting attorneys fees, noting that institutional investors are "experienced and sophisticated consumers of legal services." *Id.* at 2105-06. Weiss and Beckerman speculated that if institutional investors frequently served as lead plaintiffs, plaintiff-side securities law firms would grow increasingly concerned about their long-term reputations with such investors and thus might have less incentive to shirk in particular cases. *See id.* at 2106-07. The authors acknowledged that fee structures negotiated by institutional lead plaintiffs might "differ substantially from the fee structure that courts currently employ," but suggested that courts "might well feel confident in assuming that a fee arrangement an institutional investor had negotiated with its lawyers before initiating a class action maximized those lawyers' incentives to represent diligently the class's interests, reflected the deal a fully informed client would negotiate, and thus presumptively was reasonable." *Id.* at 2105.

Soon after Weiss and Beckerman's article was published, Congress enacted the PSLRA. The statute establishes a detailed and integrated procedure for selecting a lead plaintiff and for choosing and retaining lead counsel in securities class actions that is unquestionably based on Weiss and Beckerman's proposal. *Compare* 15 U.S.C. § 78u-4(a)(3), *with* Weiss & Beckerman, 104 Yale L.J. at 2105-09. *See generally* S. Rep. No. 104-98, at 11 n.32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690 n.32 (stating that Weiss and Beckerman's article "provided the basis for the 'most adequate Plaintiff' provision").

B. The Reform Act's Procedures; Selection of the CalPERS Group As Lead Plaintiff

The Reform Act establishes a two-step process for appointing a lead plaintiff: the court first identifies the presumptive lead plaintiff, and then determines whether any member of the putative class has rebutted the presumption. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I) & (II). We begin by describing the manner in which courts charged with appointing a lead plaintiff should proceed under the PSLRA. We then measure the actions taken by the District Court against these standards.

1. Legal Standards

a. Identifying the Presumptive Lead Plaintiff

In appointing a lead plaintiff, the court's first duty is to identify the movant that is presumptively entitled to that status. The process begins with the identification of the movant with "the largest financial interest in the relief sought by the class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(bb). In many cases (such as this one, *see supra* Part II.B), this determination will be relatively easy, but in others it may prove difficult. The Reform Act provides no formula for courts to follow in making this assessment, but we agree with the many district courts that have held that courts should consider, among other things: (1) the number of shares that the movant purchased during the putative class period; (2) the total net funds expended by the plaintiffs during the class period; and (3) the approximate losses suffered by the plaintiffs. *See Lax v. First Merch. Acceptance Corp.*, No. 97

C 2715, 1997 WL 461036, at *5 (N.D. Ill. Aug. 11, 1997); *see also In re Nice Sys. Sec. Litig.*, 188 F.R.D. 206, 217 (D.N.J. 1999) (citing *Lax* for this proposition); *In re Olsten Corp. Sec. Litig.*, 3 F. Supp. 2d 286, 295 (E.D.N.Y. 1998) (same).

Any time the question appears genuinely contestable, we think that a district court would be well within its discretion in requiring that competing movants submit documentation as to their holdings in the defendant company or companies and in seeking further information if it deems the original submissions to be an inadequate basis for an informed decision. Once the court has identified the movant with "the largest financial interest in the relief sought by the class," it should then turn to the question whether that movant "otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure," and is thus the presumptively most adequate plaintiff. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(cc). This latter requirement casts into stark relief a serious ambiguity contained in the Reform Act's mechanism for selecting a lead plaintiff.

The section of the PSLRA that governs the appointment of the lead plaintiff is captioned "Rebuttable Presumption." The first subsection, captioned "[i]n general," provides that "the court shall adopt a presumption that the most adequate plaintiff . . . is the person or group of persons that": (1) filed the complaint or made a motion to serve as the lead plaintiff; (2) "in the determination of the court, has the largest financial interest in the relief sought by the class;" and (3) "otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure." *Id.* § 78u-4(a)(3)(B)(iii)(I). The next

subsection, captioned "[r]ebuttal evidence," declares that the presumption established by the previous subsection "may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff — (aa) will not fairly and adequately protect the interests of the class; or (bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class." *Id.* § 78u-4(a)(3)(B)(iii)(II).

The draftmanship of this section is inartful and hence problematic. The first subsection states that a movant is not entitled to the lead plaintiff presumption unless it "otherwise satisfies" Rule 23. The two provisions of that Rule that are relevant to this issue are 23(a)(3) and 23(a)(4). The former requires that a party seeking to represent a class have "claims or defenses [that] are typical of the claims or defenses of the class" [hereinafter "the typicality requirement"]. The latter mandates that a representative party be able to "fairly and adequately protect the interests of the class" [hereinafter "the adequacy requirement"]. Read in isolation, the provision of the Reform Act that deals with triggering the presumption (i.e., 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)(cc)) seems quite clear that a court must ensure that a movant satisfies both the typicality and adequacy requirements of Rule 23 before conferring upon that movant the status of presumptive lead plaintiff.

This conclusion, however, is in some tension with the second subsection (i.e., 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II)), which seems to establish that the only way to rebut the presumption is to show that the presumptive lead plaintiff *does not* satisfy the typicality and/or adequacy requirements. The statute thus simultaneously appears to make "typicality"

and "adequacy" both part of the threshold identification of the presumptive lead plaintiff *and* the sole means of rebutting the lead plaintiff presumption. Put another way, if the requirements of the first subsection are met, the statute can be read to say that the requirements of the second subsection are moot. To say the least, it is difficult to believe that Congress intended such an incongruity.

The overall structure and legislative history of the statute suggest that in appointing a lead plaintiff a district court should engage in the following analysis. The initial inquiry (i.e., the determination of whether the movant with the largest interest in the case "otherwise satisfies" Rule 23) should be confined to determining whether the movant has made a *prima facie* showing of typicality and adequacy. The initial clause of the statute, which governs triggering the presumption, refers to determinations made by "the court," 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I), but the second, which deals with rebutting it, speaks of "proof by a member of the purported plaintiff class," *id.* § 78u-4(a)(3)(B)(iii)(II). This phrasing suggests that the threshold determination of whether the movant with the largest financial losses satisfies the typicality and adequacy requirements should be a product of the court's independent judgment, and that arguments by members of the purported plaintiff class as to why it does not should be considered *only* in the context of assessing whether the presumption has been rebutted.

Moreover, both the statutory structure and the legislative history suggest that the court's initial inquiry as to whether the movant with the largest losses satisfies the typicality and adequacy requirements need not be extensive. The first

subsection (the one that deals with triggering the lead plaintiff presumption) requires that a movant "otherwise satisf[y]" Rule 23, but the second (which covers rebutting it) requires "proof" that the presumptively most adequate plaintiff does not. The provision as a whole would make little sense if we interpreted the first subsection as requiring that a movant "prove" that it satisfied Rule 23 in order to get the benefit of the lead plaintiff presumption, because that would create a situation in which the only way to rebut the presumption would be to "disprove" something that the presumptively most adequate plaintiff had already "proved." But if, in contrast, the first subsection requires only a *prima facie* showing that the movant with the largest losses satisfies Rule 23, the two subsections are reasonably harmonious.

Lastly, this reading is consistent with the legislative history. In explaining why institutional investors would make desirable lead plaintiffs, the Conference Committee Report opines that "[i]nstitutional investors and other class members with large amounts at stake will represent the interests of the plaintiff class more effectively than class members with small amounts at stake. The claims of both types of class members generally will be typical." H.R. Conf. Rep. 104-327, at 34 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 737. The terms of this language reflect the view that institutional investors and others with large losses will, more often than not, satisfy the typicality and adequacy requirements. Thus, although the language of the first subsection does not permit courts simply to "presume" that the movant with "the largest financial interest in the relief sought by the class" satisfies the typicality and adequacy requirements, both the structure of the section as a whole and the legislative history support

the view that the court's initial inquiry should be confined to determining whether such movants have stated a *prima facie* case of typicality and adequacy. *See, e.g., Gluck v. Cellstar Corp.*, 976 F. Supp. 542, 546 (N.D. Tex. 1997) (stating that in determining whether a movant is entitled to presumptive lead status, "[a] comprehensive reading of the statute reveals that [the movant] need only make a preliminary showing that it satisfies [the typicality and adequacy] requirements"); *In re Olsten Corp. Sec. Litig.*, 3 F. Supp. 2d 286, 296 (E.D.N.Y. 1998) (same); *In re Advanced Tissue Sci. Sec. Litig.*, 184 F.R.D. 346, 349 (S.D. Cal. 1998) (same); *In re Milestone Sci. Sec. Litig.*, 183 F.R.D. 404, 414 (D.N.J. 1998) (same).

In conducting the initial inquiry as to whether the movant with the largest losses satisfies the typicality and adequacy requirements, the court may and should consider the pleadings that have been filed, the movant's application, and any other information that the court requires to be submitted. In keeping with the statutory text, however, the court generally will not consider at this stage any arguments by other members of the putative class; rather, such allegations should be dealt with in terms of assessing whether the lead plaintiff presumption has been rebutted rather than in terms of deciding whether it has been triggered.

When making these determinations, courts should apply traditional Rule 23 principles. Thus, in inquiring whether the movant has preliminarily satisfied the typicality requirement, they should consider whether the circumstances of the movant with the largest losses "are markedly different or the legal theory upon which the claims [of that movant] are based differ[ ] from that upon which the claims of other

class members will perforce be based." *Hassine v. Jeffes*, 846 F.2d 169, 177 (3d Cir. 1988) (internal quotation marks and citation omitted); *see also Georgine v. Windsor*, 83 F.3d 610, 631 (3d Cir. 1996) (same).

In assessing whether the movant satisfies Rule 23's adequacy requirement, courts should consider whether it "has the ability and incentive to represent the claims of the class vigorously, [whether it] has obtained adequate counsel, and [whether] there is [a] conflict between [the movant's] claims and those asserted on behalf of the class." *Hassine*, 846 F.2d at 179; *see also Georgine*, 83 F.3d at 630 (stating that the adequacy of representation inquiry involves consideration of both whether "the interests of the named plaintiffs [are] sufficiently aligned with those of the absentees" and whether "class counsel [is] qualified and [will] serve the interests of the *entire* class"); *GM Trucks*, 55 F.3d at 800 (same).

In making the initial adequacy assessment in this context, courts should also consider two additional factors. Because one of a lead plaintiff's most important functions is to "select and retain" lead counsel, *see* 15 U.S.C. § 78u-4(a)(3)(B)(v), one of the best ways for a court to ensure that it will fairly and adequately represent the interests of the class is to inquire whether the movant has demonstrated a willingness and ability to select competent class counsel and to negotiate a reasonable retainer agreement with that counsel, *see, e.g.*, *In re Quintus Sec. Litig.*, No. C-00-4263, slip op. at 9 (N.D. Cal. Apr. 12, 2001).[46] Thus, a court might conclude that the

46. In *Quintus*, Judge Walker found that a movant for the lead plaintiff position did not otherwise satisfy Rule 23 because he had (Cont'd)

movant with the largest losses could not surmount the threshold adequacy inquiry if it lacked legal experience or sophistication, intended to select as lead counsel a firm that was plainly incapable of undertaking the representation, or had negotiated a clearly unreasonable fee agreement with its chosen counsel, *see, e.g.*, *Raftery v. Mercury Fin. Co.*,

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not "demonstrated that he is able effectively to select and retain lead counsel." *Id.* at 30. In a sworn declaration, the movant stated that he had made his choice of counsel "based on his broker's advice and after conversations with lawyers at the firm," that he had "discussed and considered a variety of fee structures with his counsel and ha[d] developed an understanding of how fees are customarily charged in litigation of this type," and that he had "negotiated an agreement with counsel . . . that [he] believe[d] [would] maximize recovery for the class." *Id.* Judge Walker found this insufficient to support a conclusion that the movant satisfied Rule 23's adequacy requirement, noting that the declaration gave "no specifics" about the process by which the movant had selected and negotiated with his chosen counsel. Judge Walker was most concerned about a statement that one of the movant's chosen lawyers had made at the hearing held to consider the appointment of lead plaintiff. The lawyer had informed the court "that the fee negotiated by [the movant] paid expenses out of the class's recovery, rather than out of counsel's portion of the recovery," but then explained that "counsel, of their own accord, had decided to sweeten the terms of the agreement and allow expenses to be deducted from counsel's share of the recovery; pending approval by [the movant] who did not know about this concession." *Id.* at 31. Though finding "counsel's benevolence towards the class . . . commendable," Judge Walker could not "conclude that [the movant] negotiated anything close to a competitive fee in light of counsel's willingness to modify the fee, without being asked, to require counsel to pay all litigation expenses." *Id.* "Benevolence of counsel," Judge Walker wrote, "is no substitute for hard bargaining." *Id.*

No. 97 C 624, 1997 WL 529553, at *2 (N.D. Ill. Aug. 15, 1997) (refusing to recognize a movant as the presumptive lead plaintiff because the court was of the view that the retainer agreement between it and its chosen counsel, which "capped" counsel's fees at 33 1/3 % of the class's total recovery, was "not the result of hard bargaining").[47] We stress, however, that the question at this stage is not whether the court would "approve" that movant's choice of counsel or the terms of its retainer agreement or whether another movant may have chosen better lawyers or negotiated a better fee agreement; rather, the question is whether the choices made by the movant with the largest losses are so deficient as to demonstrate that it will not fairly and adequately represent the interests of the class, thus disqualifying it from serving as lead plaintiff at all.

The second additional factor that the court should consider in making the threshold adequacy determination will arise only when the movant with the largest interest in the relief sought by the class is a group rather than an individual person or entity. The PSLRA explicitly permits a "group of persons" to serve as lead plaintiff. *See* 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I); *see also id.* § 78u-4(a)(3)(B)(i) (providing that the court "shall appoint as lead plaintiff the member *or members* of the purported plaintiff class that the court determines to be the most capable of adequately representing

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47. After its disqualification of the movant with the largest financial interest on the grounds outlined above, the court decided to select the lead plaintiff and lead counsel by means of an auction. *See id.* at *3. We do not ally ourselves with this latter decision, which, for reasons stated *infra* at Part IV.C.2, we think would be inappropriate in the typical Reform Act case.

the interests of class members") (emphasis added). But the goal of the Reform Act's lead plaintiff provision is to locate a person or entity whose sophistication and interest in the litigation are sufficient to permit that person or entity to function as an active agent for the class, *see, e.g.*, H.R. Conf. Rep. No. 104-369, at 32 (1995) *reprinted in* 1995 U.S.C.C.A.N. 730, 731; S. Rep. No. 104-98, at 10 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 689; Weiss & Beckerman, 104 Yale L.J. at 2105-06, and a group is not entitled to presumptive lead plaintiff status unless it "otherwise satisfies" Rule 23, which in turn requires that it be able to "fairly and adequately protect the interests of the class." If the court determines that the way in which a group seeking to become lead plaintiff was formed or the manner in which it is constituted would preclude it from fulfilling the tasks assigned to a lead plaintiff, the court should disqualify that movant on the grounds that it will not fairly and adequately represent the interests of the class.

We note at this juncture that we disagree with those courts that have held that the statute invariably precludes a group of "unrelated individuals" from serving as a lead plaintiff. *See, e.g.*, *Sakhrani v. Brightpoint, Inc.*, 78 F. Supp. 2d 845, 853 (S.D. Ind. 1999); *In re Telxon Corp. Sec. Litig.*, 67 F. Supp. 2d 803, 811-16 (N.D. Ohio 1999); *In re Donnkenny Inc. Sec. Litig.*, 171 F.R.D. 156, 157-58 (S.D.N.Y. 1997). The statute contains no requirement mandating that the members of a proper group be "related" in some manner; it requires only that any such group "fairly and adequately protect the interests of the class." We do not intimate that the extent of the prior relationships and/or connection between the members of a movant group should not properly

enter into the calculus of whether that group would "fairly and adequately protect the interests of the class," but it is this test, not one of relatedness, with which courts should be concerned.

If, for example, a court were to determine that the movant "group" with the largest losses had been created by the efforts of lawyers hoping to ensure their eventual appointment as lead counsel, it could well conclude, based on this history, that the members of that "group" could not be counted on to monitor counsel in a sufficient manner. *See, e.g., In re Razorfish, Inc. Sec. Litig.*, No. 00 CV 9474 JSR, 2000 WL 476504, at *3 (S.D.N.Y. May 4, 2001) (refusing to appoint as lead plaintiff a group that, in the court's view, was "simply an artifice cobbled together by cooperating counsel for the obvious purpose of creating a large enough grouping of investors to qualify as 'lead plaintiff,' which can then select the equally artificial grouping of counsel as 'lead counsel' ").

Courts must also inquire whether a movant group is too large to represent the class in an adequate manner. At some point, a group becomes too large for its members to operate effectively as a single unit. *See, e.g., Chill v. Green Tree Fin. Corp.*, 181 F.R.D. 398, 408-09 (D. Minn. 1998) ("[T]he larger [the size of a proposed lead plaintiff group], the greater the dilution of the control that [the members of that group] can maintain over the conduct of the putative class action.") (internal quotation marks and citation omitted). When that happens, the PSLRA's goal of having an engaged lead plaintiff actively supervise the conduct of the litigation and the actions of class counsel will be impossible to achieve, and the court should conclude that such a movant does not

satisfy the adequacy requirement. *See, e.g.*, *In re Advanced Tissue Sci. Sec. Litig.*, 184 F.R.D. 346, 352 (S.D. Cal. 1998) (refusing to appoint a group consisting of "over 250 unrelated investors" because of the court's determination that doing so would be "inconsistent with the goal of restoring control over lawsuits to plaintiffs instead of counsel"); *Chill*, 181 F.R.D. at 408 (declining to confer presumptive lead plaintiff status upon a "group" with almost 300 members because doing so "would threaten the interests of the class, would subvert the intent of Congress, and would be too unwieldy to allow for the just, speedy and inexpensive determination of this action").

Like many of the district courts that have considered this question, we do not establish a hard-and-fast rule; instead, we note only that a kind of "rule of reason prevails." *See, e.g.*, *Advanced Tissue*, 184 F.R.D. at 352; *Chill*, 181 F.R.D. at 409. We do, however, agree with the Securities and Exchange Commission that courts should generally presume that groups with more than five members are too large to work effectively. *See Brief for the Securities and Exchange Commission as Amicus Curiae* at 17 n.13.

We do not intimate that other reasons could not justify a court's decision that the Rule 23's adequacy of representation requirement is not satisfied. If (for any reason) the court determines that the movant with the largest losses cannot make a threshold showing of typicality or adequacy, then the court should explain its reasoning on the record (so that appellate courts will have an adequate basis for review) and disqualify that movant from serving as lead plaintiff. The court should then identify the movant with the next largest

loss, consider whether that movant satisfies Rule 23's requirements, and repeat this process until a presumptive lead plaintiff is identified. *See, e.g.*, *Raftery*, 1997 WL 529553, at *2-4, *7 (identifying a presumptive lead plaintiff after disqualifying two movants with larger losses, one on grounds of a typicality and one on grounds of inadequacy).

b. Determining Whether the Presumption Has Been Rebutted

Once a presumptive lead plaintiff is located, the court should then turn to the question whether the presumption has been rebutted. The Reform Act is quite specific on this point, providing that the presumption "may be rebutted *only* upon proof *by a member of the purported plaintiff class* that the presumptively most adequate plaintiff — (aa) will not fairly and adequately protect the interests of the class; or (bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II) (emphasis added). This language makes two things clear. First, only class members may seek to rebut the presumption, and the court should not permit or consider any arguments by defendants or non-class members. *See, e.g.*, *Gluck v. Cellstar Corp.*, 976 F. Supp. 542, 550 (N.D. Tex. 1997) ("The statute is clear that only *potential plaintiffs* may be heard regarding the appointment of a Lead Plaintiff."). Second, once the presumption is triggered, the question *is not* whether another movant might do a better job of protecting the interests of the class than the presumptive lead plaintiff; instead, the question is whether anyone can prove that the presumptive lead plaintiff will not do a "fair[ ] and adequate [ ]" job. We do not suggest that this is a low standard, but merely stress that the inquiry *is not* a relative one.

If no class member succeeds in rebutting the presumption, then the district court should appoint the presumptive lead plaintiff as the lead plaintiff. If the presumption has been rebutted, the court must begin the process anew (i.e., identifying which of the remaining movants has the highest financial interest in the class's recovery, assessing whether that movant satisfies the threshold typicality and adequacy requirements, and determining whether the presumption has been rebutted) until a lead plaintiff is selected.

2. Application of the Standards Here

Under these standards, we believe that the District Court correctly identified the CalPERS Group as the presumptively most adequate plaintiff. The Group filed a motion to serve as lead plaintiff, and no party has questioned that of all the movants it has the largest financial interest in the relief sought by the Class. The District Court expressly found that the CalPERS Group satisfied Rule 23(a)'s typicality requirement. *See In re Cendant Corp. Litig.*, 182 F.R.D. 144, 149-50 (D.N.J. 1998). Although we have expressed concerns about certain potential conflicts of interest that might have undermined the CalPERS Group's position, we have concluded that they do not carry the day. *See supra* Part III.B.1(a).

The District Court also found no obvious reason to doubt that a group composed of the three largest pension funds in the United States could adequately protect the class's interests. The CalPERS Group's members are legally sophisticated entities, their chosen counsel are well-qualified,

and the Retainer Agreement that they negotiated was not plainly unreasonable. Moreover, although it is a group, there is no indication that the CalPERS Group was artificially created by its lawyers, and the fact that it contains three members offers no obvious reason to doubt that its members could operate effectively as a single unit. We therefore find no abuse of discretion in the District Court's determination that the CalPERS Group was the presumptive lead plaintiff.

We also conclude that the District Court was correct in holding that the CalPERS Group's presumptive lead plaintiff status had not been rebutted. Appellant Aboff and Douglas Wilson (who is not before us on appeal) offered three reasons why the statutory presumption in favor of the CalPERS Group had been rebutted. First, Aboff and Wilson represented that "they had negotiated a reduced fee schedule with their attorneys." *Id.* at 148. As we stressed above, the question at this stage is not whether Aboff and Wilson would have done a *better* job of securing high-quality, low-cost counsel than the CalPERS Group; the question is whether the former have put forward "proof" that the latter would "not fairly and adequately represent the class." Had Aboff and Wilson shown that: (1) their fee agreement was substantially lower than that negotiated by the CalPERS Group; (2) their chosen counsel were as qualified or more qualified than those chosen by the presumptive lead plaintiff; *and* (3) the CalPERS Group had no adequate explanation for why it made the choice that it did, then the presumption may have been rebutted. But this would only happen if the facts suggested that the CalPERS Group had performed inadequately in an objective sense. But Aboff and Wilson did not make this showing simply by alleging that they negotiated a lower fee; hence

we hold that the District Court did not abuse its discretion in rejecting this argument.

Aboff and Wilson's second contention was that the presumption had been rebutted because "considerations other than the interests of the class might have influenced the CalPERS group when it retained its attorneys." *Id.* at 148. Specifically, they alleged that "counsel for the CalPERS group had made substantial contributions to the campaign of the New York State Comptroller, who, as sole trustee of the [NYS]CRF [a member of the CalPERS Group], has substantial influence over the decisions of the fund," and they argued that this "created an appearance of impropriety because the contributions may have played a role in the selection of the group's counsel — a practice known as 'pay-to-play.' " *Id.* at 148-49. We likewise find no abuse of discretion in the District Court's decision to reject this argument.

Lest we be misunderstood, we observe that actual *proof* of pay-to-play would constitute strong (and, quite probably, dispositive) evidence that the presumption had been rebutted. A movant that was willing to base its choice of class counsel on political contributions instead of professional considerations would, it seems to us, have quite clearly demonstrated that it would "not fairly and adequately protect the interests of the class." Thus, had Aboff and Wilson backed up their claims, the District Court would have likely been justified in holding that the presumption had been rebutted and disqualifying the CalPERS Group from serving as lead plaintiff.

The problem for Aboff and Wilson is that the District Court expressly found that they had not provided evidence in support of their pay-to-play allegations, *see id.* at 149, and we have no basis upon which to disagree. When pressed by the District Court, Aboff and Wilson admitted that they had no evidence that the contributions, themselves legal, had influenced the CalPERS Group's selection process.[48] Allegations of impropriety are not proof of wrongdoing. If they were, then any class member (or lawyer seeking to be appointed lead counsel) could disable any presumptive lead plaintiff by making unsupported allegations of impropriety. We therefore hold that the District Court did not abuse its discretion in rejecting Aboff and Wilson's pay-to-play arguments.[49]

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48. At oral argument before this Court, Aboff argued that it had been unable to back up its allegations because the District Court had denied it discovery. The Reform Act is quite clear on this score: an objecting class member is entitled to discovery "only if the plaintiff first demonstrates a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class." 15 U.S.C. § 78u-4(a)(3)(B)(iv). Under this standard, it is doubtful that Aboff would have been entitled to discovery (if indeed it asked).

49. Although we have held that the District Court was correct to reject Aboff and Wilson's pay-to-play allegations based on a lack of evidence and to appoint the CalPERS Group as lead plaintiff, we call attention to a situation that Congress may not have contemplated when it enacted the PSLRA. Congress clearly anticipated that pension funds would seek to serve as lead plaintiffs; indeed, that likelihood was seen as a specific benefit of the legislation. *See* H.R. Conf. Rep. No. 104-369, at 34 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733.

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What is unclear, however, is whether Congress considered a particular risk that seems unique to publicly-managed pension funds. The concern is that an informal quid pro quo could develop in which law firms specializing in securities class actions would contribute to the campaign coffers of the elected officials who oversee those funds, and that, in exchange (and in the hopes of getting more contributions), those officials would use their control over the funds to select those firms to serve as lead counsel for cases in which the funds are the lead plaintiff. In such a situation, there would also be reason to fear that the lead plaintiff would be complacent and unwilling to object to an excessive fee request, thus defeating the Reform Act's goal of lead plaintiff-controlled, rather than lead counsel-controlled, litigation. Were such a scenario to occur, the elected official's conduct — besides representing a breach of fiduciary duty to the pensioners — would threaten the best interests of the class members. Though we stress that there is no evidence of such impropriety in this case, Congress does not appear to have considered this risk when it enacted the Reform Act and may wish to revise the PSLRA to account for it.

In the absence of any such amendment, district courts should be particularly attuned to the risk of pay-to-play. In cases where a court determines that a publicly-managed fund is the presumptively most adequate plaintiff, the court could properly require that the fund disclose any campaign contributions by the fund's choice of counsel to any elected officials possessing direct oversight and authority over the fund. If any such contributions have been made, the court could also require that the fund submit a sworn declaration describing the process by which it selected counsel and attesting to the degree to which the selection process was or was not influenced by any elected officials.

Courts must also, however, take care to prevent the use of discovery to harass presumptive lead plaintiffs, something that the Reform Act was meant to guard against. The statute is clear that

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Aboff and Wilson's last submission was that the court "should select lead plaintiff through a process of competitive bidding." *Id.* at 149. The District Court refused, noting that "the PSLRA permits no such thing." *Id.* We agree. *See supra* Part IV.B.1 (discussing the procedures that the Reform Act establishes for selecting a lead plaintiff). We therefore hold that the District Court was correct to appoint the CalPERS Group as lead plaintiff.

C. The Auction

We turn now to NYCPF's objection to the District Court's decision to employ an auction to select lead counsel. We first address Lead Counsel's argument that NYCPF is not entitled to object to the auction. Concluding that it is, we then consider whether the PSLRA ever permits a district court to select lead counsel via competitive bidding. Finding that it does (though only under very specific circumstances), we analyze whether the District Court's decision to hold an auction here was justified.

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"discovery relating to whether a member . . . of the purported plaintiff class is the most adequate plaintiff may be conducted by a plaintiff only if the plaintiff [seeking discovery] first demonstrates *a reasonable basis* for finding that the presumptively most adequate plaintiff is incapable of adequately representing the class." 15 U.S.C. § 78u-4(a)(3)(B)(iv) (emphasis added). We reiterate that evidence of campaign contributions, standing alone, does not create "a reasonable basis" sufficient to justify party-conducted discovery, though it would certainly (as noted earlier) be enough for the court, on its own initiative, to seek further information from the presumptive lead plaintiff.

Appendix A

1. May NYCPF Validly Object to the Auction?

The only party that objects to the District Court's decision to select lead counsel via an auction is NYCPF; the other two members of the CalPERS Group, CalPERS and NYSCRF, have not appeared before us to argue this issue. Lead Counsel offers a litany of related reasons why NYCPF may not validly press its arguments before us, but, at bottom, its submissions reduce to two claims: (1) NYCPF lacks standing; and (2) NYCPF has waived the right to object to the auction.

Lead Counsel's first contention appears to be that NYCPF lacks standing to object to the auction in its capacity as a member of the CalPERS Group. Lead Counsel notes that in the Retainer Agreement executed between them and lead counsel, the members of the CalPERS Group "agree[d] to prosecute this litigation together and on an equal basis." Lead Counsel submits that the Retainer Agreement is governed by New Jersey law and contends that, under that law, the language quoted above establishes the CalPERS Group as a joint venture. *See Lead Counsel's Opening Br.* at 47. And, asserts Lead Counsel, because New Jersey's default partnership rules provide that decisions of a partnership are made by majority vote, NYCPF cannot object on behalf of the CalPERS Group without the approval of at least one of its partners.

We disagree. We do not decide whether Lead Counsel is correct about the legal effect of the Retainer Agreement, though we note that NYCPF vigorously contests Lead Counsel's submissions. *See NYCPF's Reply Br.* at 14. Instead,

we conclude that NYCPF has standing to challenge the District Court's decision to hold an auction in its capacity as a class member. The Reform Act's lead plaintiff provisions are intended to benefit the plaintiff class. It follows that a district court's deviation from the PSLRA model has the potential to harm every member of the class. We therefore hold that, regardless of whether it may object as a member of the CalPERS Group (a question that we do not decide), NYCPF has standing to object in its capacity as a class member.

Lead Counsel's second contention is that NYCPF has waived any right to object to the auction. There is no question that NYCPF raised these arguments before the District Court, *see In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 285, 303-04 (D.N.J. 2000) — the dispute is whether it did so too late. The District Court announced that it would conduct an auction on August 4, 1998, but NYCPF did not object at that time. On August 17, 1998, the CalPERS Group sent a letter to the court about the upcoming auction, and although the letter stated that the CalPERS Group had the right to "select" lead counsel, it never expressly contested the District Court's decision to hold an auction. The District Court held a hearing on August 19, 1998 for the purpose of soliciting input as to how the auction should be conducted, but, although a representative for NYCPF attended that hearing, it did not object to the auction at that time either. In fact, there does not appear to be any evidence that NYCPF objected to the District Court's decision to hold an auction until after the Settlement had been reached and it was clear that the court-ordered grid would produce a higher fee award than the

Retainer Agreement. *See id.* at 304.[50] Based on this delay, Lead Counsel suggests that we deem NYCPF's objections to have been waived.

This argument has a certain appeal, but we conclude that it is foreclosed by *In re Cendant Corp. PRIDES Litigation*, 243 F.3d 722 (3d Cir. 2001), in which we held that certain class members had standing to object to an attorneys fees award. At least in theory, the PRIDES settlement fund was large enough to provide a 100% recovery to all class members, and the attorneys fees award was not to come out of that fund. Moreover, the settlement was structured so that any unclaimed portions of the settlement or reduction in fees would revert to Cendant, rather than be distributed to the class members. As a result, lead counsel argued that the objecting class members lacked standing to object to the fee award because they could not show that they were "aggrieved" by it. Despite the force of this argument, we held that the objectors possessed standing. *See id.* at 728.

Our reasoning in *Cendant PRIDES* was twofold. First, we observed that the agency problems inherent in the class action fee awards context counseled in favor of construing standing extremely broadly. *See id.* at 728-29. And even in cases like *Cendant PRIDES* where the fee award did not directly reduce the class's recovery, we suggested that lead counsel who seek an "excessive" fee may have breached their

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50. Under the Retainer Agreement (and absent the express consent of the CalPERS Group), the maximum counsel fee would have been approximately $187 million — over $76 million dollars less than that produced by the court-ordered auction grid. *See supra* nn.4 & 9.

fiduciary duties to the class, thus entitling the class to recover any excess from its lawyers. *See id.* at 729.

Second, we emphasized the critical importance of searching judicial review of fee awards in class actions, because of the inherent conflict of interest between lead counsel and the class and because judges have an independent obligation to avoid "potential public misunderstandings" over the size of fee awards. *Id.* (internal quotation marks and citation omitted). And in so stating, we stressed that "[o]ur interest and supervisory role is pervasive and extends not only to the final fee award *but also to the manner by which class counsel is selected* and the manner by which attorneys fee conditions are established." *Id.* at 731 (emphasis added). "Because of the possible injury to [the objector] and other class members from the fee award . . . , and, more importantly, because of our overarching interest in class action fee awards," we held that the objector had standing to appeal the fee award. *Id.* at 732.

Cendant PRIDES strongly counsels against declining to hear NYCPF's objections to the auction. In that case we were willing to employ a quite broad conception of standing — a fundamental and non-waivable prerequisite for a federal court even to have jurisdiction, *see, e.g.*, *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) — to ensure that we would be able to consider the propriety of a class action fee award in view of the public interest and perception issues. Here, in contrast, Lead Counsel does not submit that NYCPF has failed to allege a constitutionally sufficient "injury in fact"; instead, it contends that we should employ the equitable doctrine of waiver to decline to consider its claim. It would

be incongruous indeed if the vital importance of searching judicial review of class action fee awards were sufficient to warrant an expansive conception of standing, but insufficient for a court to decline to invoke its equitable power not to consider certain claims. For that reason, we reject Lead Counsel's argument that we should not consider NYCPF's objections to the auction, and turn to the question whether the District Court's decision to hold an auction was consistent with the PSLRA.

2. Does the Reform Act Ever Permit an Auction?

The statutory section most directly on point provides that "[t]he most adequate plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class." 15 U.S.C. § 78u-4(a)(3)(B)(v). This language makes two things clear. First, the lead plaintiff's right to select and retain counsel is not absolute — the court retains the power and the duty to supervise counsel selection and counsel retention. But second, and just as importantly, the power to "select and retain" lead counsel belongs, at least in the first instance, to the lead plaintiff, and the court's role is confined to deciding whether to "approv[e]" that choice. Because a court-ordered auction involves the court rather than the lead plaintiff choosing lead counsel and determining the financial terms of its retention, this latter determination strongly implies that an auction is not generally permissible in a Reform Act case, at least as a matter of first resort.

This conclusion gains support when we examine the overall structure of the PSLRA's lead plaintiff section. The Reform Act contains detailed procedures for choosing the

lead plaintiff, *see supra* Part IV.B.1, indicating that Congress attached great importance to ensuring that the right person or group is selected. The only powers expressly given to the lead plaintiff, however, are to "select and retain" counsel. If those powers are seriously limited, it would seem odd for Congress to have established such a specific means for choosing the lead plaintiff. But if the powers to "select and retain" lead counsel carry a great deal of discretion and responsibility, it makes perfect sense that Congress attached great significance to the identity of the person or group that would be making those choices.

Adding support to our view that auctions are not generally permitted is the fact that the Reform Act's lead plaintiff provisions were clearly modeled after the Weiss and Beckerman proposal. The statutory language is almost identical to that suggested in Weiss and Beckerman's article, *compare* 15 U.S.C. § 78u-4(a)(3), *with* Weiss & Beckerman, 104 Yale L.J. at 2105-09, and this view is confirmed by the Senate Report, *see* S. Rep. No. 104-98, at 11 n.32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690 n.32. The entire thrust of Weiss and Beckerman's argument was that large investors would do a better job at counsel selection, retention, and monitoring than judges have traditionally done, and their proposal sought to encourage such investors to serve as lead plaintiff for that purpose. This goal would be significantly undermined were we to interpret the Reform Act as permitting courts to take decisions involving counsel selection and retention away from the lead plaintiff by ordering an auction.

Lastly, our belief that the PSLRA does not allow an auction in the ordinary case is well supported in the Reform

Act's legislative history. Both the Conference Committee Report and the Senate Report state that the purpose of the legislation was to encourage institutional investors to serve as lead plaintiff, predicting that their involvement would significantly benefit absent class members. *See* H.R. Conf. Rep. No. 104-369, at 34 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733; S. Rep. No. 104-98, at 11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690. Both Reports begin by acknowledging that lead counsel have historically chosen the lead plaintiff rather than vice versa, and by outlining the significant problems created by that phenomenon. *See* H.R. Conf. Rep. No. 104-369, at 32-33 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731-32; S. Rep. No. 104-98, at 11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690. Later, both Reports contain a brief discussion of the lead plaintiff's power to choose lead counsel:

> [The] lead plaintiff provision solves the dilemma of who will serve as class counsel. Subject to court approval, the most adequate plaintiff retains class counsel. As a result, the Conference Committee expects that the plaintiff will choose counsel rather than, as is true today, counsel choosing the plaintiff. The Conference Committee does not intend to disturb the court's discretion under existing law to approve or disapprove lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class.

H.R. Conf. Rep. No. 104-369, at 35 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 734; S. Rep. No. 104-98, at 11-12 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690.

The second sentence of the above-quoted language emphasizes that the choice belongs to the lead plaintiff, and the third is significant for two reasons. First, it confirms that the court's role is generally limited to "approv[ing] or disapprov[ing] lead plaintiff's choice of counsel;" and that it is not the court's responsibility to make that choice itself. Second, it indicates that the court should generally employ a deferential standard in reviewing the lead plaintiff's choices. It is not enough that the lead plaintiff selected counsel or negotiated a retainer agreement that is different than what the court would have done; the question is whether judicial intervention is "necessary to protect the interests of the plaintiff class."

We respect the arguments advanced by Judge Shadur — a jurist of extraordinary distinction, who, as we noted *supra* n.44, is one of the primary judicial advocates in favor of the auction method — as to why auctions are not inconsistent with the Reform Act, but we ultimately find them unpersuasive. Judge Shadur notes that the PSLRA provides that a movant's status as presumptive lead plaintiff may be overcome if it can be shown that the movant will not fairly and adequately represent the class, and observes that the statute makes the lead plaintiff's right to select and retain counsel "subject to the approval of the court." *See In re Bank One S'holders Class Actions*, 96 F. Supp. 2d 780, 784 (N.D. Ill. 2000) (quoting 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II)(aa) & (B)(v)); *see also In re Comdisco Sec. Litig.*, 141 F. Supp. 2d 951, 953 (N.D. Ill. 2000) (quoting this discussion from Bank One). Based on these two provisions, Judge Shadur writes:

Suppose for instance a plaintiff in such a presumptive status has agreed that its own lawyers, if acting as class counsel, are to receive one-third of any class recovery. Suppose further that another highly reputable law firm that has appeared of record for another putative plaintiff or plaintiffs, having demonstrated excellent credentials in earlier securities class action litigation and being clearly capable of handling the complexities of the current lawsuit, is willing to handle the case for half of that percentage fee — or to provide even a greater contrast, is willing to work for that lesser percentage and also to impose a cap on the firm's total fee payment. In that circumstance the presumptive lead plaintiff could certainly bind *itself* contractually to pay one-third of its share of the class recovery to its own lawyer, but any court would be remiss if it were to foist that one-third contingency arrangement on all of the other class members who had not themselves chosen that law firm to be their advocate. . . .

In this Court's view, if the presumptive lead plaintiffs were to insist on their class counsel handling the action on the hypothesized materially less favorable contractual basis, that insistence would effectively rebut the presumption that the putative class representatives, despite the amounts that they have at stake personally, were indeed the "most adequate plaintiffs" — that is, the class members "most capable of adequately representing

> the interests of class members" (Subsection (a)(3)(B)(i)). If on the other hand the presumptive class representative were willing to be represented by the most favorable qualified bidder among the lawyers submitting bids, with that bidder either supplanting the presumptive lead plaintiff's original choice of counsel or working together with that original counsel (but with the total lawyers' fees to be circumscribed by the low bidder's proposal), the presumption would clearly remain unrebutted and the presumptive most adequate plaintiffs would properly be appointed as lead plaintiffs.

Bank One, 96 F. Supp. 2d at 784.

As should be clear from our discussion of the proper means of appointing a lead plaintiff, *see supra* Part IV.B.1, we concur with the first portion of Judge Shadur's analysis. In a situation like the one he describes, we think it quite clear that the presumptive lead plaintiff's actions (especially if it could offer no persuasive reason for preferring the first, more expensive firm, to the second, equally-qualified but less expensive one) would demonstrate that it would not fairly and adequately represent the interests of the class. This, of course, would require the court to disqualify that movant from serving as the lead plaintiff and to locate another movant that could serve in that capacity. It would not, in our view, require the court to appoint the movant whose lawyer had offered to work for half as much as the lawyers for the first movant.

As the foregoing makes clear, we part company with Judge Shadur insofar as he argues that his hypothetical shows that the Reform Act necessarily permits an auction. Judge Shadur's view appears to be that any movant who is unwilling to be represented by the firm or firms that a court determines to be the lowest qualified bidder in a court-conducted auction has necessarily shown that it will not fairly and adequately represent the interests of the class. We disagree for two reasons. First, this approach is in considerable tension with the text of the PSLRA. As we explained above, the Reform Act makes clear that it is the lead plaintiff's job to "select and retain" lead counsel and it is the court's duty to decide whether to "approve" that choice. But under Judge Shadur's approach, a presumptive lead plaintiff's only option is to assent to the counsel and the fee terms that were chosen by the court via a court-ordered auction (because otherwise the movant will be disqualified from serving as lead plaintiff on the grounds that it will not fairly and adequately represent the interests of the class). Judge Shadur's reading of the statute in effect confers upon *the court* the right to "select and retain" counsel and limits the lead plaintiff to deciding whether to acquiesce in those choices, thus eliminating any discretion on the part of the lead plaintiff. We simply do not think that such a result is consistent with the statutory text.

Moreover, we do not agree that the fact that a presumptive lead plaintiff refuses to accede to the counsel or fee terms set via an auction demonstrates that it will not fairly and adequately represent the interests of the absent class members. As we explained earlier, the Reform Act's lead plaintiff provisions (which include the section that confers on the lead plaintiff the rights to select and retain

lead counsel) were based on Weiss and Beckerman's article. A central thrust of Weiss and Beckerman's argument was that institutional investors would likely do a better job than courts at selecting, retaining, and monitoring counsel than courts have traditionally done. *See* 104 Yale L.J. at 2105-07. Whether we (or Judge Shadur) would agree with this proposition is irrelevant; what is clear is that Congress *did*. And if institutional investors are as good or better than courts at balancing quality and cost in selecting class counsel, then it follows that the fact that those investors may choose different lawyers and negotiate different fee arrangements than the court does not demonstrate that those investors will not fairly and adequately represent the interests of the class. We therefore respectfully disagree with Judge Shadur that the use of court-ordered auctions can be squared with the PSLRA in the ordinary case.

Instead, we think that the Reform Act evidences a strong presumption in favor of approving a properly-selected lead plaintiff's decisions as to counsel selection and counsel retention. When a properly-appointed lead plaintiff asks the court to approve its choice of lead counsel and of a retainer agreement, the question is not whether the court believes that the lead plaintiff could have made a better choice or gotten a better deal. Such a standard would eviscerate the Reform Act's underlying assumption that, at least in the typical case, a properly-selected lead plaintiff is likely to do as good or better job than the court at these tasks. Because of this, we think that the court's inquiry is appropriately limited to whether the lead plaintiff's selection and agreement with counsel are reasonable on their own terms.

In making this determination, courts should consider: (1) the quantum of legal experience and sophistication possessed by the lead plaintiff; (2) the manner in which the lead plaintiff chose what law firms to consider; (3) the process by which the lead plaintiff selected its final choice; (4) the qualifications and experience of counsel selected by the lead plaintiff; and (5) the evidence that the retainer agreement negotiated by the lead plaintiff was (or was not) the product of serious negotiations between the lead plaintiff and the prospective lead counsel. *See, e.g., In re Nice Sys. Sec. Litig.*, 188 F.R.D. 206, 223 (D.N.J. 1999) ("Not only should the proposed counsel fees be the result of hard-bargaining, but the initial selection of counsel should be the result of independent decision-making by the lead plaintiff.").

We do not mean for this list to be exhaustive, or to intimate that district courts are required to give each of these factors equal weight in a particular case; at bottom, the ultimate inquiry is always whether the lead plaintiff's choices were the result of a good faith selection and negotiation process and were arrived at via meaningful arms-length bargaining. Whenever it is shown that they were not, it is the court's obligation to disapprove the lead plaintiff's choices. *See, e.g., Sherleigh Assocs. LLC v. Widmere-Durable Holdings, Inc.*, 184 F.R.D. 688, 692-93 & n.1 (S.D. Fla. 1999) (rejecting a lead plaintiff's choice of a "consortium of ten law firms" on the grounds that it was "not in the best interests of the class members").

Although we think, for reasons explained above, that an auction is impermissible in most Reform Act cases, we do not rule out the possibility that it could be validly used. If

the court determines that the lead plaintiff's initial choice of counsel or negotiation of a retainer agreement is inadequate, it should clearly state why (for both the benefit of the lead plaintiff and for the record) and should direct the lead plaintiff to undertake an acceptable selection process. If the lead plaintiff's response demonstrates that it is unwilling or unable to do so, then the court will, of necessity, be required to take a more active role.

At that point, a court will have several options. If a litigant were to have repeatedly undertaken a flawed process of selecting and retaining lead counsel, that may be enough to show that it will not fairly and adequately protect the interests of the class. In such a situation, the court would be justified in disqualifying that litigant from serving as lead plaintiff, selecting a new lead plaintiff, and directing that newly-appointed lead plaintiff to undertake an acceptable search.

On the other hand, it is possible that the court could conclude that, perhaps due to the nature of the case at hand, none of the possible lead plaintiffs is capable of fulfilling the model contemplated by the Reform Act, i.e., a sophisticated investor who has suffered sizeable losses and can be counted on to serve the interests of the class in an aggressive manner. In such a situation, it would be permissible for a court to conclude that its obligation to protect the interests of the plaintiff class makes it necessary for the court to assume direct control over counsel selection and counsel retention, and, were the court to so conclude, an auction would be one permissible means by which the court could

select and retain counsel on behalf of the class.[51] We stress, however, that it is not sufficient justification for an auction in a case governed by the Reform Act that the court prefers a process of counsel selection or counsel retention that it, rather than the lead plaintiff, controls, nor is it enough that the court thinks that an auction is an inherently superior mechanism for determining a reasonable fee.

3. Was the Auction in this Case Permissible?

We now analyze whether, under these precepts, the District Court's decision to conduct an auction was justified. We begin by rejecting the contention that the court's willingness to permit counsel chosen by Lead Plaintiff to match what the District Court determined to be the lowest qualified bid fully protected the CalPERS Group's right to "select and retain" lead counsel. First, because the court's order gave the matching power to the Group's choice of counsel rather than to the Group itself, this approach did not, in fact, preserve the Group's ability to "select" lead counsel. Moreover, because the court's order meant that Lead Plaintiff's choice would be honored only if it was made pursuant to fee terms set by the District Court, the court's approach also undermined the CalPERS Group's ability to "retain" counsel.

In its written opinion, the District Court gave several reasons for holding an auction. First, it noted that the PSLRA makes Lead Plaintiff's decision "subject to the approval of

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51. Our position here is in substantial accord with that advanced by the Securities and Exchange Commission. *See* Brief for the Securities and Exchange Commission as Amicus Curiae at 20-23.

the court." The court stressed that "given the opportunity, absent class members would try to secure the most qualified representation at the lowest cost," and then observed that, at the end of the case, it would be required to ensure that the "[t]otal attorneys's fees and expenses" that it awarded to lead counsel did "not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class." *In re Cendant Corp. Litig.*, 182 F.R.D. 144, 150 (D.N.J. 1998). The court concluded that holding an auction would aid it in making this determination and in protecting the class's interests because it would simulate the market, thus providing a "benchmark of reasonableness." *Id.* at 150-52. Second, the District Court stated that holding an auction would have the "salutary" effect of "remov[ing] any speculative doubt" about Aboff and Wilson's pay-to-play allegations. *Id.* at 152.

These reasons are not sufficient justification for holding an auction. The first (i.e., a generalized desire to hold down costs by "simulating" the market) would apply in every case, and thus cannot be enough to justify a procedure that we have concluded may only be used rarely. Further, there is no need to "simulate" the market in cases where a properly-selected lead plaintiff conducts a good-faith counsel selection process because in such cases — at least under the theory supporting the PSLRA — the fee agreed to by the lead plaintiff is the market fee.

Nor do we think that the laudable desire to dispel mere allegations of impropriety as to one member of the CalPERS Group is enough to justify holding an auction. Were it sufficient, then any disgruntled class member (or lawyer

seeking to be appointed lead counsel) could disable the lead plaintiff from exercising its statutorily-conferred power by making unsupported allegations of impropriety.

It could also be argued that two of the District Court's statements during the August 4 and August 19, 1998, hearings support its decision to hold an auction. To begin with, we doubt that any of these musings could properly be seen as "findings" sufficient to justify the court's actions. But even if they could, we find these proffered reasons simply inadequate. During the August 4 hearing, the District Court suggested that institutional investors may not do a good job of selecting lead counsel because "at times familiarity or a long time association between a client and a lawyer . . . may limit arms length bargaining." These "concerns" cannot justify the court's decision to hold an auction because there was simply no evidence of "familiarity or a long time association" between any member of the CalPERS Group and either of the firms that the Group proposed retaining, nor was there any evidence of or finding by the District Court that arms-length bargaining had not, in fact, taken place.

We are similarly unable to conclude that the auction was justified based on the District Court's statement during the August 19 hearing that "one can make the argument . . . that because of [their] economic power that at times [large investors] get a little complacent economically and therefore . . . they are not as cost effective as they should be." First, as a generic supposition, this intuition is directly at odds with the principles that animated the Reform Act. Second, the court never made findings that the CalPERS Group had been "complacent economically" or had demonstrated that it would not be "as cost effective as [it] should be."

Appendix A

At oral argument before this Court, Lead Counsel offered two additional arguments in favor of the District Court's decision to conduct an auction. Lead Counsel's first contention was that at the time of its decision to hold an auction on August 4, the court knew nothing about the process by which the CalPERS Group had selected and retained its choice of counsel. As a consequence, Lead Counsel submits that the District Court could not be confident at that time that Lead Plaintiff had conducted a thorough and good faith counsel search, and argues that this uncertainty (combined with Aboff's and Wilson's pay-to-play allegations) justified the court's decision to hold an auction. Lead Counsel's second argument was that the entire litigation landscape had changed between the time Lead Plaintiff and Lead Counsel entered into the Retainer Agreement and the time of the August 4 hearing. This is because on July 14, 1998, shortly after the Retainer Agreement became effective on June 23, Cendant announced that it would be restating three years of CUC's financial statements instead of just one. Lead Counsel submits that Cendant's July 14 announcement fundamentally altered the dynamics of this case, and contends that this development justified the Court's August 4 decision to hold an auction.

We find these arguments unpersuasive. First, we note that the District Court never gave them as reasons for holding an auction. Second, though Lead Plaintiff does not appear to have submitted much information about the thoroughness and integrity of the process by which it selected and retained counsel prior to the District Court's decision to conduct an auction (although Lead Counsel did describe it to the court as "the best fee ever negotiated in advance" and "the hardest

bargain ever driven in a securities class action case," 109 F. Supp. 2d at 291-93), it is also true that the District Court did not order Lead Plaintiff to provide such information or give any indication that it was concerned about the process by which Lead Plaintiff selected counsel and negotiated the Retainer Agreement. Although we have no doubt that a court may (and should) require that a lead plaintiff provide information about the process it used to select and retain counsel before deciding whether to "approv[e]" that choice, *see* 15 U.S.C. § 78u-4(a)(3)(B)(v), Lead Plaintiff cannot be faulted for not producing the information that the statute does not expressly require and that the court did not seek. *Cf. Laborers Local 1298 Pension Fund v. Campbell Soup Co.*, No. CIV.A. 00-152 (JEI), 2000 WL 486956, at *4 (D.N.J. Apr. 24, 2000) (giving the lead plaintiff advance notice of the questions the court will want answered before deciding whether to approve its choice of lead counsel); Proceedings of the 2001 Third Circuit Task Force on the Selection of Class Counsel, Statement of Vaughn R. Walker, at 22 (Appendix A), available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/vwalker.pdf (providing questionnaire that Judge Walker has distributed to lead plaintiff candidates regarding their method of selecting and retaining their chosen counsel).

Third, although a fundamental and unexpected change in the litigation landscape would probably be the sort of thing that would justify a district court's decision to decline to approve a proposed retainer agreement (or to order that a previously approved retainer agreement be renegotiated), the proper remedy would be to instruct the lead plaintiff to renegotiate an adequate agreement rather than to order an auction immediately.

For the foregoing reasons, we hold that the District Court abused its discretion by conducting an auction because its decision to do so was founded upon an erroneous understanding of the legal standards undergirding the propriety of conducting an auction under the PSLRA. With regard to counsel selection, however, this error was harmless because the counsel selected via the auction process were the same as those whom the Lead Plaintiff sought to have appointed in the first place.

D. Counsel Fees

Having determined that the District Court should not have held an auction, we face the question of what happens next. The fact that BRB and BLBG were appointed Lead Counsel after exercising their option to meet what the court determined to be the lowest reasonable auction bid makes our task considerably easier than it would have been had the District Court appointed different firms to serve as lead counsel. Cognizant of the unusual situation in which we find ourselves, we conclude that the District Court was correct to appoint BRB and BLBG as Lead Counsel, but hold that it should have done so pursuant to the Retainer Agreement negotiated between them and Lead Plaintiff. In appointing BRB and BLBG Lead Counsel (albeit for reasons that we have found to be erroneous) the District Court obviously determined that the firms were qualified to serve as counsel for the class. To our knowledge, no one has questioned that conclusion, and it is difficult to see how anyone could do so.

The matter of the Retainer Agreement is somewhat more complicated, but we think it should be deemed to be in force.

That the District Court would have approved all of its provisions except for its fee provisions is evidenced by the fact that the court required that all bidders consent to those provisions as a condition precedent to participating in the auction. And the fact that the court would have found the Retainer Agreement's fee provisions to be reasonable had it employed the correct legal standard is attested to by the fact that the court deemed the bid that BRB and BLBG submitted in connection with the auction to have been "realistic in the context of likely results." Although this bid was not the same as the fee provisions contained in the Retainer Agreement, *see In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 285, 291 n.3 (D.N.J. 2000), Lead Counsel has represented to us that it contained only "minor modifications," which were made "because the litigation 'milestones' of the court's fee grid did not precisely match the 'milestones' of the agreement." Lead Counsel's Br. at 17 n.7.

Besides Aboff's and Wilson's pay-to-play allegations (which the District Court rejected based on insufficient proof — a finding with which we have no quarrel), no party has come forward with supportable allegations that Lead Plaintiff did not select and retain BRB and BLBG through a sufficiently sophisticated and sincere search. We therefore hold that the District Court should have appointed BRB and BLBG Lead Counsel pursuant to the Retainer Agreement, and we also conclude that that Agreement is currently in force.

In light of this conclusion, we think that the District Court erred in considering and ruling upon Lead Counsel's fee application. The Retainer Agreement states that Lead Counsel "will not submit any fee application to the Court without the

prior approval of The Funds," but there is insufficient evidence that either CalPERS or NYSCRF gave their "prior approval."[52] Lead Counsel originally relied on the fact that neither CalPERS nor NYSCRF objected to its fee request, but acquiescence (which is the most that a failure to object shows) is not the same thing as "prior approval."

Lead Counsel also points to an off-the-record conference conducted by the District Court on May 22, 2001, which was apparently attended by representatives for Lead Counsel, NYCPF, and NYSCRF. NYSCRF was represented by its General Counsel, Randall Treece, and Lead Plaintiff asserts that Treece had been given CalPERS's proxy by its General Counsel, Kayla Gillan. Lead Counsel maintains that at the May 22 conference, the court "made clear that . . . the result of the auction process had superseded the fee provisions of the retainer agreement, and that class counsel had a right to rely on the fee grid set by the court and was entitled to seek a fee in that amount." At this point, according to Lead Counsel, Treece "thanked the court for its guidance and stated that [NYS]CRF and CalPERS would accept the court's view."

We need not decide whether this version of events, if true, would demonstrate that NYSCRF and CalPERS gave their "prior approval" to Lead Counsel's fee request. The facts remain that NYCPF disputes Lead Counsel's account; neither Treece nor anyone else from NYSCRF or CalPERS has confirmed it or stated that Lead Counsel has accurately stated their views; and the fact that this conference was held

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52. As noted earlier, we need not and do not decide whether "prior approval of The Funds" means *all* of the Funds or a *majority* of the Funds. *See supra* Part IV.C.1.

off the record makes it impossible for us to assess what really happened.[53] Because Lead Counsel has submitted insufficient evidence that its fee request was submitted with "the prior approval of The Funds" and because the fee request was submitted pursuant to the fee grid arrived at via the auction rather than that contained in the Retainer Agreement, we hold that the request was improper under the Retainer Agreement and that the District Court should not have considered it. We will therefore set aside the District Court's fee award and remand this case with instructions to dismiss the fee application and to decline to accept any further applications that are submitted without the prior approval of the Funds.[54]

Our conclusion that the current fee request is improper under the Retainer Agreement makes it unnecessary for us to engage in a substantive review of the fee award approved by the District Court. But this is the seventh appeal in the *Cendant* proceedings, *see supra* n.11, and, with others still in progress, we think it necessary to say a few words about the standards that should guide the District Court's discretion in considering fee requests under the PSLRA that will be the principal focus on remand so as to help bring this now protracted matter to a close.

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53. Moreover, it is unclear whether a failure to object just after the court emphatically stated what it was going to do would even qualify as acquiescence, much less "approval."

54. This disposition makes it technically unnecessary for us to decide whether Aboff is correct that the Settlement Notice was defective with regard to Lead Counsel's request for attorneys fees or whether Throenle is correct that the fee request was improper as matter of law. At all events, we conclude that both arguments are meritless.

The Reform Act confers on the lead plaintiff the power to "retain" lead counsel, 15 U.S.C. § 78u-4(a)(3)(B)(v), but it also requires that the court ensure that the "[t]otal attorneys' fees and expenses awarded . . . to counsel for the plaintiff class . . . not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class." *Id.* § 78u-4(a)(6). This latter provision makes clear that the court has an independent obligation to ensure the reasonableness of any fee request. The issue is the scope of this obligation.

Federal Rule of Civil Procedure 23(e) provides that no class action "shall . . . be dismissed or compromised without the approval of the court," but the detailed standards set forth for reviewing attorneys fees in this Court's earlier cases are not contained in any statute or rule. Rather, they were developed because of recognition that in the class action context there is no way for "the class" to select, retain, or monitor its lawyers in the way that an individual client would, and because of doubts that a typical lead plaintiff in the non-PSLRA context is a terribly good agent for the class. In the ordinary case, the court is the only disinterested agent capable of protecting the class from its lawyers and its primary means of doing so is by scrutinizing the lawyers' proposed fee. In such a context, searching judicial review of fee requests is both necessary and appropriate to ensure that the interests of absent class members are not compromised. *See supra* Part IV.A.1 & 2.

The Reform Act shifts the underpinnings of our class action attorneys fees jurisprudence in the securities area. As a preliminary matter, the PSLRA sets out a detailed procedure

for choosing lead plaintiffs, the whole point of this process being to locate a lead plaintiff that will be an effective agent for the class. The properly-selected lead plaintiff is then charged with selecting and retaining lead counsel (subject to court approval). This regime is far different from the traditional case in which counsel is often "selected" and "retained" based on the fact that it filed the first suit. Consequently, courts have far more reason at the outset to think that counsel selection and retention were done in the best interests of the class in a typical Reform Act case than they do in other class action contexts, at least when the procedures of counsel selection employed by the lead plaintiff were adequate.

The same holds true of the monitoring of class counsel. In the typical class action, there is little reason to think that the lead plaintiff has the incentive or ability to monitor lead counsel's performance, but there is good reason to think that a lead plaintiff that has been properly selected under the PSLRA would possess both. In this context, the lead plaintiff is in the best position, under the PSLRA's scheme, to determine (at least initially) what its lead counsel's fee should be. Our jurisprudence must take account of that change.

We therefore believe that, under the PSLRA, courts should accord a presumption of reasonableness to any fee request submitted pursuant to a retainer agreement that was entered into between a properly-selected lead plaintiff and a properly-selected lead counsel. *See* Weiss & Beckerman, 104 Yale L.J. at 2105 ("[A] court might well feel confident in assuming that a fee arrangement an institutional investor had negotiated with its lawyers before initiating a class action

maximized those lawyers' incentives to represent diligently the class's interests, reflected the deal a fully informed client would negotiate, and thus presumptively was reasonable."). This presumption will ensure that the lead plaintiff, not the court, functions as the class's primary agent vis-à-vis its lawyers. Further, by rendering ex ante fee agreements more reliable, it will assist those agreements in aligning the interests of the class and its lawyers during the pendency of the litigation.

Saying that there is a presumption necessarily assumes that it can be overcome in some cases, however. First, the presumption of reasonableness would likely be abrogated entirely were the court to find that the assumptions underlying the original retainer agreement had been materially altered by significant and unusual factual and/or legal developments that could not reasonably have been foreseen at the time of the original agreement. If such developments occurred early enough in the litigation, the court might wish to inform the lead plaintiff and lead counsel of its concerns and direct them to renegotiate the fee agreement. If, however, the changes were to come to light late in the day, and if the lead plaintiff and the lead counsel were unable to agree to a revised fee schedule to account for that change, the court could be justified in holding that the presumption of reasonableness had been abrogated and to review the fee request using the traditional standards.

We stress, however, that not just any factual or legal development would suffice to justify a court's decision that the presumption of reasonableness had been rebutted on grounds of changed circumstances. Uncertainties are part of

any ex ante negotiation and it should be presumed that the lead plaintiff and the lead counsel took the possibility of uncertainty into account in negotiating their agreement. Thus, only unusual and unforeseeable changes, i.e., those that could not have been adequately taken into account in the negotiations, could justify a court's decision to find the presumption abrogated.

Even if the presumption of reasonableness is not undermined by changed circumstances, however, courts must still consider whether it has been rebutted. As we have noted above, there is an arguable tension between the presumption of reasonableness accorded the arrangement between the Lead Plaintiff and properly selected counsel and the duty imposed on the Court by the Reform Act, 15 U.S.C. § 78u-4, to insure "[t]hat total attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class." We resolve this tension by holding that the presumption may be rebutted by a prima facie showing that the (properly submitted) retained agreement fee is clearly excessive. In terms of the policy of the Reform Act, we do not believe that candidates for lead plaintiff designation will be deterred by the understanding that their retainer fee arrangement with Lead Counsel will be subject to judicial review for clear excessiveness.

In making this clear excessiveness inquiry, district courts should be primarily guided by the factors set forth in *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 195 n.1 (3d Cir. 2000), in which we set forth standards for evaluating whether

the percentage fee, which essentially had supplanted the lodestar on our class action counsel fee jurisprudence, was excessive. Under *Gunter*, the Court should examine:

> (1) the size of the fund created and the number of persons benefitted; (2) the presence or absence of substantial objections by members of the class to the settlement terms and/or fees requested by counsel; (3) the skill and efficiency of the attorneys involved; (4) the complexity and duration of the litigation; (5) the risk of nonpayment; (6) the amount of time devoted to the case by plaintiffs' counsel; and (7) the awards in similar cases.

Gunter v. Ridgewood Energy Corp., 223 F.3d 190, 195 n.1 (3d Cir. 2000). But, as our cases have recognized, factors (1), (3), and (7) "should receive less weight" in mega-fund cases such as this one. *See, e.g., In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 148 F.3d 283, 339 (3d Cir. 1998).[55]

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55. Following the lead of the 1985 Task Force Report, several of this Court's cases have stated that, ordinarily, the percentage of a recovery devoted to attorneys fees should decrease as the size of the overall settlement or recovery increases. *See* 1985 Task Force Report, 108 F.R.D. at 256; *Prudential*, 148 F.3d at 339; *In re Cendant Corp. PRIDES Litig.*, 243 F.3d 722, 736 (3d Cir. 2001). In *Prudential*, we explained that "[t]he basis for this inverse relationship is the belief that in many instances the increase in recovery is merely a factor of the size of the class and has no direct relationship to the efforts of counsel." 148 F.3d at 339 (internal quotation marks and citation omitted). This position, however, has been criticized by respected courts and commentators, who contend that such a fee scale often gives counsel an incentive to settle cases too early and too cheaply. (Cont'd)

Gunter review will, however, need to be modified to take into account some of the changed circumstances brought about by the PSLRA. First, the aim in this context is not to assess whether the fee request is reasonable; instead, the goal is to determine whether the presumption of reasonableness has been rebutted. As a consequence, the discussions of these factors that have appeared in our prior cases will not necessarily apply in cases governed by the Reform Act. Second, courts should employ a deferential standard of review in assessing factor (3) ("the skill and efficiency of the attorneys") because the PSLRA assumes that properly-selected lead plaintiffs are at least as able to answer those questions as courts. Lastly, factor (7) ("the awards in similar cases") may be of limited use, at least in the first generation of Reform Act cases. As we have explained, the PSLRA shifts the entire backdrop against which our fee jurisprudence has developed, and, as a consequence, non-PSLRA cases may not be sufficiently "similar" to provide a meaningful basis for comparison.[56]

(Cont'd)

See, e.g., In re Auction Houses Antitrust Litig., 197 F.R.D. 71, 80-81, 84 n.55 (S.D.N.Y. 2000) (outlining the advantages and problems with the use of decreasing and increasing fee scales, and ultimately concluding that an increasing fee scale was more appropriate in that particular case); 2001 Task Force Proceedings, Statement of Samuel Issacharoff, at 7, available at http://www.ca3.uscourts.gov/classcounsel/Witness%20Statements/samissac.pdf (arguing that a decreasing percentage scale simply gives counsel an incentive to settle cheap). We need not decide at this time whether the deference that courts owe to fee scales negotiated by a properly-selected lead plaintiff would mandate deference to that plaintiff's decision to employ a rising-percentage fee scale in a particular case.

56. *In re Cendant Corp. PRIDES Litig.*, 243 F.3d 722 (3d Cir.

(Cont'd)

Appendix A

Gunter acknowledges a possible role for the lodestar in this calculus, by noting the possible utility of a lodestar cross-check. *See* 223 F.3d at 200. We note in this regard that the Reform Act does not rule out the use of the lodestar. The Conference Committee Report states:

> The Conference Committee limits the award of attorney's fees and costs to counsel for a class in new section 27(a)(6) of the 1933 Act and new section 21D(a)(6) of the 1934 Act to a reasonable percentage of the amount of recovery awarded to the class. By not fixing the percentage of fees and costs counsel may receive, the Conference Committee intends to give the court flexibility in determining what is reasonable on a case-by-case basis. The Conference Committee does not intend to prohibit use of the lodestar approach as a means of calculating attorney's fees. The provision focuses on the final amount of fees awarded, not

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(Cont'd)
2001), is not to the contrary. That case, like this one, was governed by the PSLRA, but we nevertheless applied full-strength *Gunter* review rather than the version we have described here. In *Cendant PRIDES*, as here, the district court had employed an auction to select and retain lead counsel, *see id.* at 735 n.18, but that decision was not challenged on appeal in *Cendant PRIDES*. Once the use of an auction was accepted, *Cendant PRIDES* ceased to be a typical PSLRA case because the assumptions underlying the Reform Act model that we outlined above had broken down. As we have explained, *see supra* Part IV.A.2, the auction method, like the traditional approach, relies on the court to serve as the class's agent with regard to selecting and retaining lead counsel. In such a context, the full *Gunter* review that we mandated in *Cendant PRIDES* makes sense.

the means by which such fees are calculated. H.R. Conf. Rep. 104-369, *36.

Several of our cases have "recommended" that district courts compare the results at which they arrive via the percentage-of-recovery method with an abbreviated calculation of the lodestar amount. *See, e.g.*, *GM Trucks*, 55 F.3d at 822; *Prudential*, 148 F.3d at 333; *Gunter*, 223 F.3d at 199; *Cendant PRIDES*, 243 F.3d at 742.[57] The goal of this practice is to ensure that the proposed fee award does not result in counsel being paid a rate vastly in excess of what any lawyer could reasonably charge per hour, thus avoiding a "windfall" to lead counsel. The lodestar cross-check, however, is very time consuming. Thus, while the Court should in the first instance test the presumption, if challenged, by the *Gunter* factors, it may, if necessary, utilize the lodestar cross-check.[58]

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57. Arguably *Cendant PRIDES*, which, as noted above, *see supra*, n.56, was not decided as a Reform Act case, may have, by implication, elevated the lodestar cross-check from being a "recommendation" to a requirement. There the District Court had not performed a lodestar cross-check, and by our calculations the fees that it ultimately awarded were between 7 and 10 times the lodestar amount. *See* 243 F.3d at 742. We wrote that "[i]n allowing such a high multiplier . . . without even calculating it, much less explaining how it [was] justified, the District Court strayed from all responsible discretionary parameters" in granting the fee award. *Id.*

58. We note that even PSLRA sponsored fee agreements between Lead Plaintiff and Lead Counsel will typically require an accounting of hours spent, as the agreement in the present case does.

Although the foregoing discussion suggests that, in view of a presumption, whatever fee is re-submitted by Lead Counsel pursuant to the Retainer Agreement on remand has a "leg up" for approval, we cannot blind ourselves to the reality that both the fee award of $262 million under the auction and (potentially up to) $187 million under the Retainer Agreement are staggering in their size, and, on the basis of the evidence in the record, may represent compensation at an astonishing hourly rate (as well as an extraordinarily high lodestar "multiplier," *see supra* n.57). Objectors contend that the lodestar figure is approximately $8,000,000, which would mean that the multiplier would be 45.75 if lead counsel were to receive the court awarded fee, and approximately 24 if it were to receive the negotiated fee. Lead counsel counter that the $8,000,000 figure was preliminary and that the final figure will be much higher, from 50% to 100%. Even so, the multiplier would still be extremely high.

At all events, this was a simple case in terms of liability with respect to Cendant, and the case was settled at a very early stage, after little formal discovery. Thus the possibility of rebuttal of the presumption of reasonableness must be seriously considered by the District Court on remand. If the *Gunter* factors (and possible lodestar cross-check) were to confirm that the fee agreed to by a lead plaintiff and lead counsel was clearly excessive, the court would need to set a reasonable fee according to the standards our previous cases have set down for class actions not governed by the PSLRA. If the District Court does consider the lodestar, it might think of it as a floor and the fee under the retainer agreement as a ceiling. In such event, it should explain on the record its reasons for selecting a fee award at or between these two figures.

V. Conclusion

For the reasons stated above, the District Court's orders approving the Settlement and the Plan of Allocation will be affirmed. We hold that the District Court was correct to appoint the CalPERS Group as lead plaintiff but that it erred in holding an auction to select and retain lead counsel. The latter error was harmless with respect to the identity of Lead Counsel, but not with respect to the determination of its fee. Because we believe that, absent the error, the court would have properly appointed BRB and BLBG as lead counsel pursuant to the Retainer Agreement entered into between the firms and the CalPERS Group, we hold that the Agreement remains in force. Consequently, the fee award will be vacated and the case remanded with instructions to the District Court to dismiss the fee request as improper under the Retainer Agreement and to decline to consider any further fee requests that are not submitted with the "prior approval of the Funds." In considering any such fee requests, the Court will be guided by our discussion herein. Parties to bear their own costs.

A True Copy:
Teste:

Clerk of the United States Court of Appeals for the Third Circuit

APPENDIX B — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY DATED AUGUST 14, 2000 AND FILED AUGUST 15, 2000

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Civ. No. 98-1664 (WHW)

IN RE CENDANT CORPORATION
SECURITIES LITIGATION

OPINION

Walls, District Judge

Pursuant to Federal Rule of Civil Procedure 23(e), Lead Plaintiffs, the New York State Common Retirement Fund ("NYSCRF"), the California Public Employees' Retirement System ("CalPERS") and the New York City Pension Fund ("NYCPF"), move for (i) approval of two settlements, one with Cendant Corporation ("Cendant") and the HFS Individual Defendants named below, and one with Ernst & Young LLP ("E&Y"), and (ii) approval of the Plan of Allocation of the Net Settlement Fund. The Cendant settlement provides for a payment to the class of $2,851,500,000 in cash, provides for additional payment to the class from Cendant and the HFS Individual Defendants in the event they recover damages in their suits against E&Y — 50% of any recovery — and imposes certain corporate governance changes on Cendant. The E&Y settlement provides for a cash payment of $335,000,000 to the class. For the reasons stated, the settlements and Plan of Allocation are approved.

Appendix B

A. The Action

Cendant was formed by the merger of CUC International, Inc. ("CUC") and HFS Incorporated ("HFS") on December 17, 1997. CUC, the surviving corporation, was renamed Cendant after the merger. Holders of HFS common stock were issued shares of CUC common stock pursuant to a Registration Statement dated August 28, 1997 ("Registration Statement") and a Joint Proxy Statement/Prospectus. Am. Compl. ¶ 33.

On March 31, 1998, Cendant filed its Form 10-K Annual Report with the SEC including its 1997 financial statements. Two weeks later, after the close of the stock market on April 15, 1998, Cendant announced that it had discovered accounting irregularities in certain former CUC business units. As a result, it announced that it expected to restate its annual and quarterly financial statements for 1997 and possibly for earlier periods as well. The next day, Cendant's stock fell 47%, from $35-5/8 to $19-1/16 per share. Shareholder suits were then filed in this and other districts against Cendant, its officers and directors, and other parties including E&Y. E&Y had acted as CUC's independent public accountant from 1983 through the formation of Cendant, and post-merger audited the financial statements of Cendant Membership Services ("CMS"),[1] a wholly-owned subsidiary of Cendant, for the year ended December 31, 1997. These

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1. Simultaneously with the Merger, all of the businesses formerly operated by CUC and all of CUC's assets were transferred to CUC Membership Services, Inc. On December 29, 1997, CUC Membership Services, Inc., changed its name to Cendant Membership Services.

financial statements of CMS were consolidated into Cendant's financial statements and included in Cendant's Form 10-K for the 1997 fiscal year. On July 14, 1998, Cendant announced that it would also restate CUC's annual and quarterly financial statements for 1995 and 1996. Following this announcement, Cendant's stock fell by another 9% to $15-11/16 per share. Finally, on August 28, 1998, Cendant filed with the SEC a report prepared by Willkie Farr & Gallagher ("WF&G"), the law firm it had engaged to perform an independent investigation, which disclosed, among other things, that Cendant would restate its 1995, 1996, and 1997 financial statements by approximately $500 million. Cendant's stock then fell 11% to $11-5/8 on August 31, 1998, the first trading day after Cendant's disclosure of the audit report.

Following the selection of Lead Plaintiffs and approval of Lead Counsel (the process is addressed in companion opinion discussing Lead Counsel's fee request), on December 14, 1998, Lead Plaintiffs filed an amended and consolidated class action complaint on behalf of all persons and entities who purchased or acquired Cendant or CUC publicly traded securities, excluding PRIDES, during the period of May 31, 1995 through August 28, 1998 (the "class period"), and were injured thereby. Concurrently, plaintiffs filed a motion for class certification, granted on January 27, 1999.

The Amended Complaint named as defendants Cendant, E&Y, and individual officers and directors of Cendant, CUC, and HFS. Lead Plaintiffs alleged that defendants Walter A. Forbes, E. Kirk Shelton, Christopher K. McLeod, Cosmo Corigliano, and Anne M. Pember, officers of CUC before

the merger, reviewed or were aware of the false and misleading statements alleged in the complaint, and "were in a position to control or influence their contents or otherwise cause corrective or accurate disclosures to have been made." Am. Compl. ¶¶ 16-17. The complaint asserted that the following defendants, together with defendants Walter Forbes, Shelton, and McLeod, were members of CUC's Board of Directors before the merger, signed the Registration Statement, and were named therein as directors of Cendant upon the completion of the merger: Burton C. Perfit, T. Barnes Donnelley, Stephen A. Greyser, Kenneth A. Williams, Barlett Burnap, Robert R. Rittereiser, and Stanley M. Rumbough, Jr. *Id.* at ¶ 18 (all of the named officers and directors of CUC are referred to collectively as the "CUC Individual Defendants"). The following defendants, except Scott Forbes, were directors of HFS before the merger and were named in the Registration Statement as directors of Cendant upon the completion of the merger: Henry R. Silverman, John D. Snodgrass, Michael P. Monaco, James E. Buckman, Scott E. Forbes, Steven P. Holmes, Robert D. Kunisch, Leonard S. Coleman, Christel DeHaan, Martin L. Edelman, Brian Mulroney, Robert E. Nederlander, Robert W. Pittman, E. John Rosenwald, Jr., Leonard Schutzman, and Robert F. Smith (collectively, the "HFS Individual Defendants"). Scott Forbes served as the Senior Vice President-Finance of HFS and then Cendant from August 24, 1993 to April 15, 1998, and later the Executive Vice President and Chief Accounting Officer of Cendant.

Plaintiffs claimed that defendants made several materially false and misleading statements during the class period. Plaintiffs alleged that a number of CUC and Cendant's

filings with the SEC from June 1995 through April 1998 were materially false and misleading as were their press releases from May 31, 1995 through June 2, 1998 in which they announced their quarterly and annual earnings. Am. Compl. ¶¶ 66-67. These press releases and SEC filings, according to plaintiffs, contained or incorporated by reference Cendant and CUC financial statements that were not prepared in conformity with Generally Accepted Accounting Principles ("GAAP") and contained other assertions that were materially false and misleading. Am. Compl. ¶¶ 68-82. In particular, plaintiffs alleged that Cendant and CUC overstated their revenues, net income, and operating income for the 1995, 1996, and 1997 fiscal years through various improper accounting practices. These included manipulation of merger reserves (reserves created which consist of the anticipated future costs of a business combination), irregular revenue recognition practices, CUC's improper accounting for membership cancellations, as well as a number of other improper accounting practices by CUC and its subsidiaries including Comp-U-Card. Am. Compl. ¶¶ 71-78.

In addition, plaintiffs asserted that the August 28, 1997 Registration Statement and the Joint Proxy Statement/ Prospectus were materially false and misleading because of the financial statements incorporated by reference therein, misrepresentations contained in the Merger Agreement which was an appendix to the Joint Proxy Statement/Prospectus, and misrepresentations regarding the "due diligence" conducted by HFS in connection with the merger. Am. Compl. ¶¶ 86-102. The complaint further maintained that E&Y failed to audit CUC's annual and quarterly reports for 1995, 1996, and 1997 in accordance with Generally Accepted

Auditing Standards ("GAAS") and review standards established by the American Institute of Certified Public Accountants (the "AICPA"). Am. Compl. ¶ 7. Plaintiffs claimed that E&Y's misrepresentations included: its assertions in its certifications that it had audited CUC's financial statement in accordance with GAAS; that it had planned and performed those audits to obtain reasonable assurance that the financial statements were free of material misstatements; that in its opinion, CUC's financial statements presented CUC's financial position fairly, in conformity with GAAP; and that its audits provided a "reasonable basis" for its opinions. Am. Compl. ¶ 134.

Plaintiffs plead that all defendants violated § 11 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77k; that Cendant violated § 12(a)(2) of the Securities Act, 15 U.S.C. § 77*l*(a)(2); that defendants Walter Forbes, Shelton, McLeod, and Corigliano violated § 15 of the Securities Act, 15 U.S.C. § 77o; that defendants Cendant, Walter Forbes, Shelton, McLeod, Corigliano, Pember, Silverman, Snodgrass, Monaco, Buckman, Scott Forbes, and E&Y violated § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5; that defendants Walter Forbes, Shelton, McLeod, Corigliano, Pember, Silverman, Snodgrass, Monaco, Buckman, and Scott Forbes violated § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a); that defendants Walter Forbes, Shelton, McLeod, Corigliano, Silverman, Snodgrass, and Buckman violated § 20A of the Exchange Act, 15 U.S.C. § 78t-1; and that Cendant, the HFS Individual Defendants except Scott Forbes, and the CUC Individual Defendants except Pember violated § 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) and Rule 14a-9, 17 C.F.R. § 240.14a-9.

Appendix B

Lead Plaintiffs successfully defended this Amended Complaint against defendants' motions to dismiss. In July 1999, the Court denied all motions except for E&Y's to dismiss plaintiffs' Section 10(b) and Rule 10b-5 claims against it for stock purchases made after April 15, 1998. *See In re Cendant Corp. Litig.*, 60 F. Supp. 2d 354 (D.N.J. 1999).

B. Lead Plaintiffs' Argument In Support of Settlement

1. The Settlements

Cendant's $2.8 billion payment represents approximately 37% of Lead Plaintiffs' estimate of reasonable compensation damages of $8.5-8.8 billion,[2] and over 58% of Cendant's estimated damages. Joint Decl. ¶ 131. This settlement provides for potential additional recovery for the class of 50% of any net recovery that Cendant or the HFS Defendants receive in any litigation against E&Y. Further, through the settlement Cendant is bound to institute significant corporate governance improvements. In exchange, the class agrees to release: "all claims that were, or could have been, brought against the CUC Defendants (who were not parties to the Stipulation), Cendant, and the HFS Individual Defendants." Lead Counsel continue:

> Inclusion of the CUC Individual Defendants was a non-negotiable condition of the Cendant Settlement. Cendant insisted that (i) it did not want

2. The aggregate damages were initially set as $8.5 billion. In post-fairness hearing briefing, the amount was adjusted upward to $8.8 billion.

> lingering cross or indemnity claims against the Company made by any CUC Individual Defendant; and (ii) it was necessary to preserve claims against those individuals, who are not settling parties, and against the liability insurance policies covering those individuals, to the maximum extent allowed by law. Lead Plaintiffs and Lead Counsel believe that such a condition was reasonable, and agreed to it in order to obtain the outstanding recovery for the Class.

The entire amount of the Cendant settlement will earn interest for the class beginning on the earlier of August 20, 2000 or five days after settlement approval. The amount will be paid into an escrow account within 120 days after the approval becomes final.

The E&Y settlement of $335 million "is the largest amount ever paid by an accounting firm in a securities class action." Brf. at 1. It earns interest for the benefit of the class as of April 14, 2000. The settlement amount and any interest will be deposited into escrow no later than 90 days after settlement approval.

2. The Plan of Allocation

The plan calculates loss amounts per Cendant share, note, or option for each day in the class period, based on the amount of artificial inflation caused by CUC and Cendant's issuance of materially false and misleading financial statements and other financial information. Each shareholder's settlement payment, then, depends on the date his or her shares were acquired (and, if applicable, sold). *See* Section G, below.

Appendix B

Those who obtained Cendant's publicly traded securities after April 15, 1998 will not receive payment from the E&Y settlement amount because the Court has dismissed all claims against E&Y for class members who purchased after this date. These purchasers, however, will receive payment from the Cendant settlement.

Further, the plan recognizes Section 11 claims of those who acquired Cendant common stock in exchange for HFS shares at merger. The interests of these class members will be calculated under the damages provision of Section 11. *See* n.10. If Section 11 damages are greater than losses determined under Section 10(b), a plaintiff will receive Section 11 statutory damages, if not, he or she will receive Section 10(b) damages.

3. Assessment

Lead Plaintiffs assert that the proposed settlements are fair, reasonable and adequate and should be approved by the Court. *See In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768 (3d Cir. 1995). Factors to be considered are:

> (1) the complexity, expense, and likely duration of the litigation . . .; (2) the reaction of the class to the settlement . . .; (3) the stage of the proceedings and the amount of discovery completed . . .; (4) the risks of establishing liability . . .; (5) the risks of establishing damages . . .; (6) the risks of maintaining the class action through the trial . . .; (7) the ability of the defendants to withstand a

> greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery . . .; [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Girsh v. Jepson, 521 F.2d 153, 157 (3d Cir. 1975); *see also* Coffee Decl. ¶ 17.

In regard to the first factor, Lead Plaintiffs assert that the claims "involve[ ] numerous complex legal and technical accounting issues." Additionally, "because this case settled prior to the taking of depositions and pre-trial preparation, there is no question that continued litigation would have greatly increased the expense and duration of this action." Brf. at 13; *see also In re IKON Office Solutions, Inc. Securities Litig.*, 194 F.R.D. 166, 2000 WL 567104 (E.D. Pa. May 9, 2000), *cited in* Coffee Decl. ¶ 17 ("in the absence of a settlement, this action will likely extend for months or even years longer"). Finally, even if a larger judgment were received at trial, additional delay would likely occur through the appellate process.

The second factor is linked to the number of objectors to settlement. Here, out of 478,000 notices of settlement sent, three class members object to the settlements (Tere Throenle, Betty Duncan (to the E&Y settlement) and Robert and Janice Davidson (objecting on behalf of themselves and various trusts)). An additional class member objects to the Plan of Allocation (Ann Mark). Two other objections by non-class members were filed, one by Martin Deutch, derivative action plaintiff, and the other by the State Board of Administration of Florida. Lead Plaintiffs state that the four class member

objectors "collectively have losses constituting less than 1/10,000 of 1% of the Class's damages." Reply Brf. at 2. The objectors' holdings are described:

- Tere Throenle purchased 100 shares of Cendant stock on April 17, 1998 and lost approximately $600;

- Betty Duncan, trustee of the Esther J. Johnston Trust, bought an unspecified number of CUC 3% Notes and claims a $1,294 loss;

- The Davidsons, as individuals and trustees, received CUC stock in July 1996 when their business was merged into the company, "and by year end had sold over 80% of it for $635 million — most of that profit";

- Ann Mark exchanged 100 HFS shares for 240 CUC shares in the merger and also purchased 400 shares in the open market.

Lead Plaintiffs add "[p]erhaps most telling is the reaction of institutional investors to the settlements. . . . Here, not one of the over 1,700 institutional investors [who owned between 78% and 98% of Cendant stock during the class period] in the Class has objected to the Settlements." *Id.* at 3. Lead Plaintiffs conclude: "The class's near unanimous support of the Settlements confirms the superior results achieved by Lead Plaintiffs and Lead Counsel." *Id.* at 3; *see also* Miller Decl. ¶ 16. The objections and Lead Plaintiffs' responses are discussed below.

The third factor looks to the stage of the proceedings. Here, Lead Counsel contend that they "conducted a thorough and efficient investigation and analysis" of all claims. As example, they hired a damages expert and an investment banking expert to evaluate Cendant's ability to contribute to settlement. *See* Joint Decl. ¶¶ 112-17. They conclude "this case had advanced to a stage where the parties 'certainly [had] a clear view of the strengths and weaknesses of their cases.' " Brf. at 16 (quoting *In re Warner Communications Securities Litig.*, 618 F. Supp. 735, 745 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986)).

Lead Plaintiffs next address the fourth factor—the risks of establishing liability:

> While Lead Counsel believe there is substantial evidence to support the Class's claims . . . the complexities and uncertainties of this litigation clearly warrant approval of the Settlements. In particular . . . the claims against E&Y and all but two of the Individual Defendants were less [strong].

Brf. at 16-17. Moreover, because of the Private Securities Litigation Reform Act's prohibition against collection of damages in excess of a defendant's determined liability, "a key factor for Lead Plaintiffs and Lead Counsel was the proportion of liability a jury was likely to assess against Cendant, E&Y and the 28 Individual Defendants." *See* 15 U.S.C. § 78u-4(f); *see generally* The Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. §§ 77k, 77*l*, 77z-1, 77z-2, 78j-1, 78t, 78u, 78u-4, & 78u-5. Lead Plaintiffs

add that the difficulty of establishing E&Y's liability is even greater due to defenses accorded to accounting firms under the PSLRA. *See* Coffee Decl. ¶ 17(c). As for the director-defendants, "of the 28 Individual Defendants, 18 were non-employee, or 'outside' directors of Cendant who were named as defendants only on claims charging violations of Section 11 of the Securities Act and Section 14 of the Securities Exchange Act." Brf. at 18. And these outside director-defendants possess a "due diligence" defense. Joint Decl. ¶ 131. Moreover, the HFS inside directors could assert this defense to Section 11 and Section 14 claims. Finally, "[o]f the five CUC Individual Defendants who were not outside directors . . . only [two] were identified by the Investigation as having played an active role" in the fraud. Brf. at 19.

With reference to the fifth factor, the risks of establishing damages, Lead Plaintiffs remark that Cendant and E&Y vigorously disputed plaintiffs' expert's conclusion that the maximum class damages total approximately $8.5 billion. Plaintiffs conclude that proof of damages at trial would, at best, result in a battle of experts with unpredictable results.

Although Lead Plaintiffs detail why defendants would be unable to withstand a greater judgment (the seventh settlement factor), their position can be summed up in three words — "Pennzoil *vs.* Texaco." In 1985, Pennzoil obtained an $11.1 billion judgment in Texas state court against Texaco for interference with contract. Texaco was unable to post bond for appeal equal to the entire amount. It instead sought bankruptcy protection and Pennzoil eventually agreed to accept a $3 billion settlement. Lead Plaintiffs allege that even if the maximum recovery were obtained at trial, Cendant

would be unable to post the necessary bond for appeal, let alone pay the amount to the class.

Lead Plaintiffs next address the final factors concerned with the range of reasonableness of the settlement(s). They repeat that the current recovery is 37% of their expert's maximum recoverable damages, which could rise if Cendant or the HFS Defendants obtain additional recovery from E&Y. They add that the recovery includes corporate governance reforms that "would not have been available remedies . . . under the federal securities laws . . . and were obtained without sacrificing any monetary award." Brf. at 24.

Plaintiffs' reply brief expands their argument that 37% of the maximum damages is a "superior result." Reply Brf. at 5. They refer to a study of 377 securities class action settlements between January 1991 and June 1996 made by the National Economic Research Association, Inc. ("NERA"), which "revealed that the average settlement comprises between 9% and 14% of plaintiffs' claimed damages." Denise Martin et al., National Econ. Research Ass'n, *Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions* 10-11 (NERA 1996). *See also In re Prudential Securities, Inc. L.P. Litig.*, MDL No. 1005, 1995 WL 798907 (S.D.N.Y. 1995) (approving settlement of between 1.6% and 5% of claimed damages); *In re Crazy Eddie Securities Litig.*, 824 F. Supp. 320 (E.D.N.Y. 1993) (settlement of between 6% and 10% of damages); *In re Michael Milken & Assocs. Securities Litig.*, 150 F.R.D. 57 (S.D.N.Y. 1993) (7.5%).

Alternatively, they propose that reasonableness of settlements may be evaluated by determining the corporate

payor's contribution as a percentage of its market capitalization. According to plaintiffs, Cendant's $2.85 billion contribution represents 21% of its 1999 average capitalization and 27% of its July 19, 2000 market capitalization. (Plaintiffs' full amount of damages — between $8.5 billion and $8.8 billion — represents approximately 95% of Cendant's market capitalization of $9.21 billion as of the close of trading August 10, 2000.) By contrast, mega-fund settlements which involved companies with capitalizations of over $1 billion ranged from 1% (*In re Waste Management, Inc.*, No. 97-7709 (N.D. Ill. 1999)) to 7.6% (*In re Informix Corp. Securities Litig.*, No. 97-1289 (N.D. Cal. 1999)) of total capitalization. Reply Brf. at 6-7. A securities case in the Eastern District of Pennsylvania, *In re IKON Office Solutions, Inc. Securities Litig.*, 194 F.R.D. 166, 2000 WL 567104 (May 9, 2000), recently settled for 6.2% of IKON's average 1999 market capitalization of $1.8 billion and between 5.2% and 8.7% of over $1 billion in claimed damages.

Lead Plaintiffs add "a final yardstick in considering the quality of a settlement is how much was available from insurance to cover the claims." Here, they state that the $3.18 billion total settlement is 12 times available insurance coverage. In contrast, the NERA report determined that class actions settlements typically amount to 3.4 times total insurance proceeds. Reply Brf. at 7.

They then address approval of the Plan of Allocation, "governed by the same standards of review applicable to the approval of the settlement as a whole: the plan must be fair, reasonable and adequate." *In re Oracle Securities Litig.*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH)

¶ 98,355 at 90,446 (N.D. Cal. June 18, 1994) (Walker, J.). This plan is briefly explained above. Lead Plaintiffs, relying on the work of Forensic Economics, Inc., assert that this plan is fair, reasonable and adequate and should be approved.

C. E&Y's Brief in Support

E&Y's brief in support of settlement focuses mainly on the risks of establishing liability and damages against it. In a preview of what will surely be argued in the Cendant-E&Y suit, the accounting firm stresses that it too was a victim of Cendant's fraud: "Plaintiffs would face daunting, and perhaps insurmountable, hurdles in attempting to prove at trial that E&Y should be liable for Cendant's admitted fraud." E&Y Brf. at 11. It agrees with Lead Plaintiffs that the estimation of damages at trial would lead to a battle of experts. Further, it asserts that "E&Y's proportional share of plaintiffs' damages is exceedingly small." *Id.* at 13. In all other respects, E&Y agrees with Lead Plaintiffs' assertions regarding the reasonableness of settlement.

D. Objectors to Settlement

Derivative Plaintiff

Derivative plaintiff, Martin Deutch, objects to the settlement both as a current shareholder whose interest in Cendant will allegedly be diminished as a result of settlement and as derivative plaintiff whose derivative claims will arguably be diminished by settlement.

He objects on the following grounds:

- The notice of settlement is defective because it does not inform shareholders that (a) certain derivative claims will be "compromised" and (b) contribution claims by Cendant against at least the HFS Individual Defendants will be barred.

- Approval of the settlement violates due process because it compromises certain derivative claims "even though the interests of the Derivative Plaintiff, the Company, and its current shareholders in those claims are not adequately represented in the class action."

- The settlement fails to allocate Cendant's payment to the class between Section 10(b) claims and Section 11 claims — critical for determining the value of remaining contribution claims if settlement occurs.

- The settlement is "grossly unfair to Cendant and its current shareholders because it likely eviscerates pending state law derivative claims and contribution claims against individual defendants, without any payment by the individual defendants for the release of those claims."

- The settlement is an illegal indemnification.

These objections along with Deutch's motion to intervene to object to settlement under Federal Rule of Civil Procedure 24 are discussed in a separate opinion. *See In re Cendant Corp. Securities Litig.*, No. 98-1664, slip. op. (D.N.J. August 14, 2000).

Appendix B

Davidsons

Class members Janice and Robert Davidson object to the settlement on behalf of themselves and as trustees of various trusts (collectively "the Davidsons").[3]

The Davidsons argue that given the size of their holdings, their objections "must be given considerable weight." Dav. Brf. at 4. Their first objection is that Lead Plaintiffs did not adequately represent their interests. They rely on the brief filed by Lead Counsel in a related dispute that contends that Lead Plaintiffs did not believe the Davidsons to be class members.[4] They assert that "[t]he failure of Class counsel to represent and protect the Davidsons' interests is reason enough to disapprove this Settlement." *Id.* at 6 (citing *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 627-28, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997)). Alternatively, they contend that because they acquired shares in connection with the purchase of their business, to effectuate settlement the court must create a subclass to represent their status. *Id.*

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3. The Davidsons moved in May 2000 to be excluded from the class. The Court ruled that their holdings fall within the class. *See In re Cendant Corp. Securities Litig.*, 194 F.R.D. 158 (D.N.J. 2000). This ruling is on appeal.

4. The Davidsons' shares were held mainly in trusts created for the benefit of charities and heirs. Lead Counsel previously argued that Janice and Robert Davidson should be excluded from the class as former CUC officers. They, however, did not argue that the trusts were excluded from the class. *See In re Cendant Corp. Securities Litig.*, 194 F.R.D. 158 (D.N.J. 2000).

They also argue that the proposed settlement is not fair to the class as a whole because members are treated unequally. Here, the settlements and Plan of Allocation are based upon a fraud on the market theory and awards damages commensurate with such a theory. Damages under this theory, however, "have not been shown by the proponents of this Settlement to be the most appropriate for class members who did not receive their shares as a result of market transactions." *Id.* at 10. Further, "[t]he Plan of Allocation essentially assumes — without proving-that the fraudulent inflation in CUC's per share stock price increased constantly throughout the Class period. It therefore assumes in and out purchasers and sellers assumed no damages." *Id.* at 8. Moreover, "Shareholders who acquired their shares early in the class period and retained them are penalized in favor of latecomers." *Id.* at 11.

Additionally, the Davidsons maintain that the proceedings leading to settlement have been deficient as a matter of law because Lead Plaintiffs were chosen when the class consisted of purchasers between May 1997 and April 1998. The class was later opened to those who received shares as early as May 1995 (encompassing the Davidsons). Yet, the Davidsons were never offered Lead Plaintiff status.

Finally, they assert that the corporate governance concessions "are entitled to no weight in this Court's consideration of the Settlement because they provide only illusory benefit to the class members." *Id.* at 15.

After the hearing of June 28, 2000, the Court allowed the Davidsons to supplement their objections to the Plan of

Allocation. They did so. Their objections and Lead Counsel's response are discussed in detail later.

Duncan

Betty Duncan, a member of the settlement class who held CUC Notes purchased on November 14, 1997 and sold on November 28, 1998, for loss of $1,294, objects to the settlement.

She first objects on behalf of non-institutional private purchasers. She claims that these "smaller" investors "have no commonality or identity of interest in terms of their financial capacity to sustain loss, their degree of investment diversification, or their level of sophistication as investors, with the designated Lead Plaintiffs." Dun. Brf. at 2.

She further objects that other than the unsupported declarations of Lead Counsel as to defendants' abilities to sustain larger settlements, "this Court has had no opportunity to receive relevant testimony from Lead Counsel's experts regarding the financial conditions, cash flows, or capacities to withstand greater judgments." *Id.* at 4. Moreover, she specifically disagrees with class counsel's conclusion that E&Y's payment was reasonable where the firm's "culpability is clear." *Id.* at 5. She takes issue with the settlement notice for two reasons (1) the notice does not inform class members of the tax consequences of the proposed settlements and (2) the notice is not understandable.

At the fairness hearing on June 28, 2000, the Court allowed Duncan to expand on her objections to the E&Y

settlement. In her second submission, Duncan argues that Cendant's amended cross-claim against E&Y conclusively demonstrates the firm's liability to the plaintiff class.[5] She further asserts: "If E&Y is involved in this fraud, they are liable for the full $8.5 billion," thus the firm's payment should be at least equal to the $2.8 billion to be paid by Cendant. Dun. Supp. Brf. at 5. She adds that E&Y can and should pay more and attacks plaintiffs' contention that the $335 million is "reasonable in light of the firm's financial resources available to satisfy a judgment." *Id.* at 6. Finally, she disputes that sufficient discovery into E&Y's alleged wrongdoing was conducted by Lead Counsel and urges the Court to (1) refuse to approve the settlement at this time because new evidence of E&Y's liability may surface as the United States Attorneys' Office conducts its investigation and (2) appoint new class counsel to prosecute the E&Y action.

Throenle

Tere Throenle, a class member who purchased 100 shares of Cendant stock on April 17, 1998, objects to settlement. She initially claims that the Notice of Settlement was defective in that it denied class members access to crucial information. For example, each settling party did not include a statement which listed "issues on which the parties disagree." 15 U.S.C. § 78u-4(a)(7)(B)(ii). The notice only

5. This Court previously declined to use allegations in a complaint filed by certain defendants in a related action to prove liability under the securities laws. *See In re Cendant Corp. Derivative Action Litig.*, 96 F. Supp. 2d 394, 401-02 (D.N.J. 2000) (declining to use allegations in complaint filed by HFS Defendants against E&Y to demonstrate Section 11 liability of the HFS Defendants).

allegedly identified one risk of continued litigation — the PSLRA's proportionate liability restrictions. Throenle asserts that this "risk" is nonsense because proportionate liability restrictions exist only where a defendant has committed no knowing violation of the law. She argues that this case involves defendants' knowing violations of the securities acts.

She further alleges that the notice stated that additional information was on file with the Clerk of the Court but "the district court clerk flatly refused Throenle's requests for the brief supporting the proposed settlements."

In addition, Throenle maintains that Lead Plaintiffs have acted only in their own interests and have abandoned the claims of individual investors. She suggests that Lead Counsel may own interests in Cendant which compromises their ability to represent the class. She also contends that the corporate governance reforms will not benefit those who no longer own Cendant stock. As for the E&Y settlement, she states "Lead plaintiffs thus propose to trade their solid case against E&Y for half of a mediocre case they do not control." Brf. at 26.

She requests permission to conduct discovery focused on adequacy of representation in order to either create a subclass or appoint new Lead Plaintiffs and Counsel. Throenle also objects to the fee request, discussed in a companion opinion.

Mark

Ann Mark objects to the Plan of Allocation on the following grounds:

- The plan fails to recognize that the Section 11 claims of former HFS shareholders are "materially stronger" than all other claims in the action.

- The Section 11 claims possessed by the former HFS shareholders are "virtually identical" to claims held by PRIDES shareholders who settled for nearly 100 cents on the dollar.

- The recent case of *Amchem Prods. v. Windsor*, mandates a strict analysis of competing interests in a class action settlement.

Florida

The State Board of Administration of Florida and the Teachers Retirement System of Louisiana submit a letter urging the Court to extend the class opt-out deadline.[6] (These objecting parties are not included in the class settlement as they have already opted out and are pursuing their own actions against Cendant.) They also ask that in settlement the Court direct all parties to the action to "hold all evidentiary materials and not destroy them" until all related actions are concluded.

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6. Florida's objection is phrased as a request to extend the opt-out deadline. As explained in *In re Cendant Corp. Securities Litig.*, 194 F.R.D. 158 (June 20, 2000), the Court will not extend the opt-out deadline absent a showing of excusable neglect under Federal Rule of Civil Procedure 6(b). Defendants object to Florida's request to hold records because Florida is not currently party to the Confidentiality Agreement signed in the main action. This agreement mandates the destruction of confidential records post-settlement.

Appendix B

E. Response to Objections

Lead Plaintiffs respond collectively to objections raised by Throenle, Duncan,[7] the Davidsons, and Mark. In reply to Throenle and Duncan's contention that the settlements are unfair because both defendants are allegedly capable of paying more, Lead Plaintiffs contend that the objections "misread the relevant standard for settlement approval," Reply Brf. at 8: "To conclude that the settlement is fair, a Court need not find that defendant paid the last dollar and can not come up with 'one additional cent, farthing or sou.' " Reply Brf. at 8.

Admittedly under *Girsh*, one relevant factor is whether defendant would be capable of sustaining a greater *judgment*, not greater *settlement*. *Girsh*, 521 F.2d at 157. Lead Plaintiffs rely on the declarations of counsel which detail investigations into Cendant and E&Y's ability to withstand greater judgment. *See, e.g.*, Joint Decl. ¶ 131, Supp. Joint Decl. ¶ 13-14 (detailing Lead Counsel's investigation into E&Y's ability to withstand judgment). They add that in order to fund this settlement, Cendant will have to *raise* money and has already retained the "services of two highly regarded financial advisors" for assistance. Reply Brf. at 8. Lead Plaintiffs amplify their concerns that Cendant would seek bankruptcy protection if it had to pay more — Texaco, for example, "had a much larger market capitalization and greater assets, net worth, revenues and cash flow than Cendant." They also refer to three other companies forced into bankruptcy by litigation: Manville Corporation (asbestos-related damages of up to

7. E&Y also filed a response to issues raised by Duncan regarding its settlement.

$12.5 billion); A.H. Robins, Co. (Dalkon Shield litigation with damages of up to $4 billion) and Dow Corning Corporation (silicon breast implant litigation).

Lead Plaintiffs add that they fully examined E&Y's insurance coverage, financial condition, and the details of the Cap Gemini deal — a condition precedent to settlement. This transaction involved the sale of E&Y's consulting business to Cap Gemini, S.A., in mid-June 2000. According to plaintiffs, "it appears that the Cap Gemini deal does not result in large payments to E&Y's partners, but rather actually provides relatively little free cash to the partnership." Reply Brf. at 11. Moreover, they argue that "holding out in hopes of obtaining a greater judgment against E&Y would entail real risk" and this should be factored into consideration of E&Y's settlement. *See* Coffee Decl. ¶ 17(c) (discussing protections accorded to accounting firms under the PSLRA).

The Court permitted Duncan to submit additional briefing of her objections to the E&Y settlement, including the issue of whether E&Y could afford a greater payment to class. E&Y and Lead Plaintiffs responded to amplify their initial contention that all *Girsh* factors favor approval of the E&Y settlement: First, further prosecution against E&Y would be enormously complex — it would involve interviews of all Cendant and E&Y personnel involved in the preparation of the three annual audits and eight quarterly reviews of Cendant by E&Y; extensive use of experts; and the possibility that a trial jury would exonerate E&Y, *see In re Health Management, Inc.*, No. 1996-889 (E.D.N.Y.) (jury found for auditor of company accused of accounting fraud because evidence indicated the company hid fraud from auditor). Lead

Plaintiffs add the likely duration of any action would be years, especially if the Court accepts Duncan's argument that the case against E&Y should wait until any criminal investigations are concluded.

Second, Lead Plaintiffs and E&Y repeat that the class reaction is favorable and not one of the large institutional investors has questioned the fairness of the E&Y settlement. Third, plaintiffs dispute Duncan's contention that insufficient discovery was conducted into E&Y's role in the alleged fraud: (a) Lead Counsel had access to and reviewed all exhibits to the Audit Committee Report with the assistance of a forensic accountant; (b) they also reviewed 32 boxes of documents produced by Cendant in its third document production; (c) the United States Attorneys' Office would undoubtedly have sought to stay depositions of any targets of its investigation pursuant to this Court's Order of July 30, 1999; (d) E&Y's financial capability to withstand a larger settlement was examined, "which, while not the determining factor in the amount of settlement, certainly was *a* factor in" accepting a settlement payment of $335 million, Reply at 8; and (e) documents prepared by the government and the SEC do not support Duncan's call to delay the E&Y settlement — they do not implicate the accounting firm but rather demonstrate that CUC senior management took steps to conceal fraud.

Fourth, the risks of establishing liability are great. "[S]uccessful cases against outside accounting firms [are] the exception." Reply at 13; *see, e.g.*, *Health Management*, discussed above; *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441 (11th Cir. 1997) (verdict against outside accounting firm vacated on appeal). E&Y has at its disposal numerous

admissions and documents of record that could be used to show that Cendant "manipulated corporate records to conceal the fraud from E&Y." Reply at 13. And E&Y also has a Section 11 defense that after reasonable investigation it had reasonable grounds to believe the Registration Statement was not misleading. E&Y concurs with Lead Plaintiff's analysis of the risks of establishing liability and adds that the recent guilty pleas of three former CUC employees only make plaintiffs' case more difficult: "the fact that these individuals went to such lengths to conceal their actions from CUC shows that E&Y did *not* participate in the fraud." E&Y Reply at 4. Moreover, these employees all implicate more senior CUC executives which, according to E&Y, demonstrates how sophisticated the concealment was. *See* E&Y Reply at 5.

Fifth, Lead Plaintiffs expand on the potential damages of E&Y. According to plaintiffs, the total damage to pre-April 1998 class members is $6.2 billion (E&Y is not potentially liable to post-April 15 purchasers). This amount would have to be reduced by the amount paid these purchasers by Cendant — approximately $2.1 of the $2.85 billion settlement, leading to a figure of $4.1 billion. Alternatively, if Duncan's assertion that Cendant and E&Y are equally responsible for the fraud is followed, E&Y is potentially liable for only $3.1 of the $6.2 billion. Then, at trial, a jury would have to determine: (1) whether E&Y violated the securities laws; (2) what E&Y's percentage of liability is as compared to all persons (including Cendant, the 28 individual defendants, third-party defendants, and non-parties); and (3) whether E&Y knowingly violated the law. (Joint and several liability against E&Y is possible only if a knowing violation is found.)

Lead Plaintiffs conclude that in light of these risks, $335 million is an "exceptional" settlement — over 10% of the hypothetical liability of $3.1 billion if Duncan's assertion of equal liability is adopted. By comparison, plaintiffs state that in two recently settled cases, accounting firms paid less than 4% of damages allegedly attributable to their conduct. *See In re Informix Corp. Securities Litig.*, No. 1997-1289 (N.D. Cal.); *In re Waste Management, Inc.*, No. 1997-7709 (N.D. Ill.). E&Y also disputes Duncan's premise that E&Y and Cendant are "equally liable." It asserts that "E&Y's proportionate share of liability for the class's damages necessarily would be miniscule when compared to the confessed liability of Cendant and its officers." E&Y Reply at 9. Sixth, Lead Plaintiffs assert that Duncan misstates the standard used to evaluate a defendant's ability to pay: "Under *G[i]rsh*, the ability to pay factor — which is one of many factors that a court should consider -- goes to ability of defendant to pay a potential *judgment*, not the ability to pay more in settlement." And "[n]o one, including Duncan, seriously contends that E&Y would have been able to pay a judgment in that amount." Reply at 19. E&Y agrees and adds that "[h]ere, it is undisputed that any judgment against E&Y for any amount approaching the plaintiffs' full damages claim would be uncollectable." E&Y Reply at 10. Finally, counsel state that no further discovery is required, a full investigation has been conducted by Lead Counsel and should not be delayed to see what, if anything, develops in the criminal investigation to implicate E&Y. Duncan's objections are considered in the Court's analysis of the *Girsh* factors.

Lead Plaintiffs next address Mark and Throenle's arguments that 37% of the recovery is unfair because PRIDES

settling class members allegedly received 100% of their losses. Initially they assert that "it is not a logical sequitur that a settlement of this case for less than 100%" is unfair or unreasonable. Reply Brf. at 12. They seek to distinguish the PRIDES settlement: (1) the CalPERS class damages are 25 times those suffered by the PRIDES class; (2) the recovery is 10 times the amount of the PRIDES settlement; (3) PRIDES were sold to the public just six weeks before the April 15, 1998 disclosure; (4) the PRIDES settlement was not a cash settlement but a "paper for paper" exchange; (5) the PRIDES claimants received no interest and CalPERS class members' claims will accrue interest until distribution; (6) PRIDES is a claims-made settlement where unclaimed shares revert to Cendant, here the entire amount will be distributed to class members; (7) the PRIDES settlement involved only Section 11 claims while this settlement involves Section 10(b) and Section 11 claims; and (8) the PRIDES settlement was for securities of uncertain value. Reply Brf. at 12. According to plaintiffs, while the PRIDES were priced at $11.71 each, they have actually traded at that amount for only 4 out of 65 days. As of June 14, 2000, they were valued at $7.25. "PRIDES claimants who still hold Rights today have a settlement representing only 60% of their damages."[8]

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8. Additionally, Lead Plaintiffs contend that if the Cendant recovery is broken down into Section 11 and Section 10(b) damages and adjusted to reflect the anticipated Section 11 recovery based on the Plan of Allocation (which finds that Section 10(b) damages are greater than Section 11 damages for nearly every trading day from April 15, 1998 through the end of the class period); and is further adjusted to take into account the 85% claim rate achieved in the PRIDES settlement, the recovery in the CalPERS action represents an approximately 52% recovery rate for class members on Section 11 claims. Reply Brf. at 14-15.

For these reasons, Lead Plaintiffs maintain that the PRIDES settlement cannot be used as a measure of reasonableness of this settlement; and, if used, the recovery rates are similar. *See* n.8.

The Court agrees with most of the reasons stated by Lead Plaintiffs: The CalPERS settlement cannot be compared to the PRIDES settlement. In particular, the "paper for paper" exchange and the claims-made settlement differentiate the two. The Court does not agree with "present market" PRIDES valuation criticism for the exchange will not be realized until February 14, 2001, when PRIDES holders will be entitled to exchange their holdings for Cendant rights at a pre-determined exchange of $11.71, present market fluctuation regardless. *See In re Cendant Corp. Prides Litig.*, 51 F. Supp. 2d 537, 540 (D.N.J. 1999). But it is significant that CalPERS class members are, instead, receiving an immediate all-cash settlement with none of the settlement fund returning to Cendant.

Lead Plaintiffs next address Throenle's objection that the corporate governance changes were obtained in lieu of additional cash recovery for the class and state that "Throenle is simply making this up." The joint declaration of Lead Counsel reads "we advised Cendant's outside counsel, and James E. Buckman, Cendant's General Counsel, that there would [be] no 'trade off' of any monetary recovery for such corporate governance changes" and adds that corporate governance changes were not negotiated "until we had reached agreement in principal on the monetary settlement with Cendant." Supp. Decl. ¶ 5. Lead Plaintiffs remark that the corporate governance changes are directly related to

claims in this case, benefit all Cendant shareholders and make the directors and officers more accountable to prevent similar problems. *See* Coffee Decl. ¶¶ 82-86. Lead Counsel volunteer that foregoing additional cash recovery for corporate governance changes is inimical to their own interests: Lead Counsel will not receive 8.275% of the hypothetical value of these changes as fee. Coffee Decl. ¶ 79.

The Court finds that Throenle's objection regarding the corporate governance changes has no substance. There has not been the slightest indication that the cash portion of the settlement was related to, dependent upon, or intertwined with the governance proposals.

Lead Plaintiffs categorize the next set of objections, common to all objectors:

> Each of the objectors complains that, in prosecuting and settling the Action, Lead Plaintiffs somehow ignored or disfavored him or her, or his or her subgroup. Unsurprisingly, now that the case has concluded, each is sure that he or she would have done a better job, and should now be appointed to "protect" the interests implicated by their claims.

Reply Brf. at 17. Lead Plaintiffs rely on this Court's earlier opinion that "Rule 23(a) does not require that every class member share every factual and legal predicate." *In re Cendant Corp. Litig.*, 182 F.R.D. 144, 148 (D.N.J. 1998). The Court added that the existence of plaintiffs with different holdings "does not justify the appointment of potentially

innumerable co-lead plaintiffs" because this "could well hamper the force and focus of the litigation." *Id.*

Lead Plaintiffs add that unlike cases where classes are certified for settlement only, the composition of the class here was already scrutinized and certified for litigation. This distinguishes the current settlement from cases relied upon by objectors where settlements were rejected because of intraclass conflicts. *See Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S. Ct. 2295, 144 L. Ed. 2d 715 (1999). In these two cases, settlements were rejected because the settlement class contained plaintiffs with competing interests. In *Amchem*, the Court concluded that as-yet uninjured members "share[d] little in common with the presently injured class members." 521 U.S. at 624.

The *Amchem* and *Ortiz* settlements were distinguished by the Eighth Circuit in *Petrovic v. Amoco Oil Corp.*, 200 F.3d 1140, 1148 (8th Cir. 1999), precisely because they were settlement, not litigation, classes. *See also* Issacharoff Decl. ¶¶ 9-15. Additionally, *Petrovic* stated that unless the court reviewing settlement finds the "stark conflicts of interest that the Supreme Court discerned in *Amchem* and *Ortiz*," a settlement which contains class members who may recover different amounts is acceptable. 200 F.3d at 1148 ("It seems to us that almost every settlement will involve different awards for various class members."). Lead Plaintiffs further rely on *In re Prudential Insurance Co. of America Sales Practices Litigation*, where the Court found that "the named plaintiffs, as well as the members of the proposed class, all have claims arising from the fraudulent scheme perpetrated

by Prudential. That overarching scheme is the linchpin [of the complaint], regardless whether each class member alleges a churning claim, a vanishing premium claim, an investment plan claim, or some other injury." 148 F.3d 283, 311 (3d Cir. 1998), *cert. denied*, 525 U.S. 1114, 119 S. Ct. 890, 142 L. Ed. 2d 789 (1999). Moreover, Lead Plaintiffs cite numerous securities cases where classes were approved which alleged injury under more than one securities law provision.[9] Reply Brf. at 22-23. They conclude that even *Amchem* recognized that "[p]redominance is a test readily met in certain cases alleging consumer or securities fraud." *Amchem*, 521 U.S. at 625.

What these objectors who seek subclasses fail to acknowledge is that this action has been proceeding as a class action for the past 20 months. Lead Counsel moved to certify the class in December 1998 and not one of these class members objected (E&Y filed an objection to class certification, later withdrawn). The Court agrees with Lead Plaintiffs that *Amchem* and *Ortiz* are readily distinguished because those actions addressed *settlement* classes — the *Amchem* and *Ortiz* courts were presented with the class definition and the settlement simultaneously. *Amchem*, 521 U.S. at 620; *Ortiz*, 119 S. Ct. at 2305. In contrast, this Court has had "the opportunity, present when a case is litigated, to

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9. They single out Mark and state that her objection that Lead Plaintiffs could not represent both class members with Section 11 claims and Section 10(b) claims is meritless as Mark herself possesses claims under both sections. Moreover, Mark's attorneys have been involved in this matter since April 1998 and have never objected to the Amended Complaint, even after receiving a draft pre-filing, and never requested certification of subclasses.

adjust the class [if necessary], informed by the proceedings as they unfold." *Amchem*, 521 U.S. at 620. Here, before announcement of the settlement, class adjustment was never requested, no decertification requests were made, and no plaintiff sought to be added as co-Lead Plaintiff. Importantly, the members of the *Amchem* and *Ortiz* classes had clear, irreconcilable interests. *See Petrovic*, 200 F.3d at 1146 ("[T]he injuries involved in those cases were extraordinarily various, both in terms of the harm sustained and the duration endured"). In contrast, CalPERS class members "share common objectives and legal or factual positions." 7A Charles Alan Wright et al., *Federal Practice and Procedure: Civil 2d* § 1769 (2d Ed. 1986), *quoted in Petrovic*, 200 F.3d at 1148. They all seek the same thing — compensation under the federal securities laws for fraud perpetrated by Cendant and other defendants. *Petrovic*, 200 F.3d at 1148; *see also In re Prudential*, 148 F.3d at 311 (stating that all claims have the same "linchpin" — "claims arising from the fraudulent scheme perpetrated by Prudential").

With regard to objections about the sufficiency of the Notice of Settlement brought by Throenle and Duncan, plaintiffs state that notice is sufficient where it is "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *See United States v. One Toshiba Color Television*, 213 F.3d 147, 2000 WL 669978, at *1 (3d Cir. May 24, 2000). Moreover, a notice of settlement "need only satisfy the broad 'reasonableness' standards imposed by due process." *Petrovic*, 200 F.3d at 1153. Lead Plaintiffs claim this standard was met and further that the notice complied with the PSLRA's mandate that it

specify whether the parties dispute the maximum amount of damages recoverable. *See* 15 U.S.C. § 78u-4(a)(7)(B)(ii).

These objections are discussed in the Court's *Girsh* analysis, below.

Finally, Lead Plaintiffs respond to objections concerning the Plan of Allocation. They state that the Plan of Allocation need not be perfect so long as it is "fair, reasonable and adequate." *See* Fed. R. Civ. P. 23. Here, according to them, the methodology — "event study methodology" — used to calculate shareholder damages during the class period "has been used by financial economists since 1969 as a tool to measure the effect on market prices from all types of new information relevant to a company's equity valuation." Reply Brf. at 32; Dorkey Aff. ¶ 18. It is so accepted, plaintiffs add, that courts now reject expert damage estimates which do not use event study methodology to evaluate the impact on the market of a company's disclosures:

> Use of an event study or similar analysis is necessary more accurately to isolate the influences of information specific to Oracle which defendants allegedly have distorted. As a result of his failure to employ such a study, the results reached by [the expert] cannot be evaluated by standard measures of statistical significance.

In re Oracle Securities Litig., 829 F. Supp. 1176, 1181 (N.D. Cal. 1993). The event study methodology used by Lead Plaintiffs increases over time the amount of share price allocable to misleading statements to take into account

cumulative effects of multiple overstatements. Dorkey Aff. ¶ 34. Lead Plaintiffs point to a similar plan of allocation praised by Judge Walker in *In re California Micro Devices Securities Litigation*, 965 F. Supp. 1327, 1332 (N.D. Cal. 1997) as "by far the most thorough, sophisticated and well substantiated" plan he has seen in a securities class action. During the fairness hearing the Court permitted the Davidsons to submit additional briefing related to their challenge to the plan. The plan is evaluated in Section G, below.

Lead Plaintiffs also address the Davidsons' argument that the escalating damages calculation in the plan ignores "in-and-out" damages. They counter that the plan does not "ignore" such damages but rather expressly rejects such damages, Miller Decl. ¶¶ 29-30, because it illustrates that those who purchased then sold Cendant stock while it was still inflated (pre-April 15, 1998) benefitted from the company's ongoing fraud and suffered no damage. "[A] plaintiff who sells a portion of stock at a profit 'should not be allowed to retain this profit in silence while pleading to be made whole for his losses.' " Miller Decl. ¶ 29 (quoting *Richardson v. MacArthur*, 451 F.2d 35, 44 (10th Cir. 1971); citing *Abrahamson v. Fleschner*, 568 F.2d 862, 878 (2d Cir. 1977)).

F. The Court's Analysis of the Proposed Settlements

1. Class Notice

Certain class members object to the sufficiency of the notice of settlement.

> "In order to satisfy due process, notice to class members must be 'reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.' " *Lachance v. Harrington*, 965 F. Supp. 630, 636 (E.D. Pa. 1997) (quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S. Ct. 652, 94 L. Ed. 865 (1950)).

IKON, 2000 WL 567104, at *6. To satisfy this standard, the notice must inform class members of (1) the nature of the litigation; (2) the settlement's general terms; (3) where complete information can be located; and (4) the time and place of the fairness hearing and that objectors may be heard. *See In re Prudential Ins. Co. of Am. Sales Practices Litig.*, 962 F. Supp. 450, 527 (D.N.J. 1997), *aff'd*, 148 F.3d 283, 311 (3d Cir. 1998), *cert. denied*, 525 U.S. 1114, 119 S. Ct. 890, 142 L. Ed. 2d 789 (1999).

And the PSLRA imposes certain other requirements, the notice must disclose: (5) the amount of the settlement and proposed distribution to plaintiffs; (6) if the parties to settlement disagree on the average amount of damages per share (as is the case here), "a statement from each settling party concerning the issue or issues on which the parties disagree"; (7) a statement of attorneys' fees or costs sought; (8) the name, address and telephone number of plaintiffs' representatives; and (9) "[a] brief statement explaining why the parties are proposing the settlement." *See* 15 U.S.C. § 78u-4(a)(7).

Appendix B

The notice sent to Cendant class members complied with these requirements. Duncan's objection that the notice of settlement is defective because it failed to advise her and others of the tax consequences is rejected as is her unsupported allegation that the notice is not understandable. *See, e.g., Prudential*, 962 F. Supp. at 530 ("this Court is unaware[ ] of any authority requiring the level of individualized information that [plaintiff] demands"). Throenle's objection to the settlement notice as failing to inform shareholders of all disputed issues is also rejected. Lead Plaintiffs were not required to list all issues on which the parties disagree, only disputed damages issues. The PSLRA provision at issue is captioned "Disagreement on Amount of *Damages*" — the Cendant notice reads: "Cendant, the HFS Individual Defendants, and E&Y deny all liability and dispute the maximum amount of damages recoverable." Notice at 1. It continues, "Defendants strongly disputed the [damages] analysis . . ., particularly the amount of recoverable damages" and adds "Cendant supplied Lead Counsel with the analyses prepared by Cendant's own financial consultants and damages experts." Notice ¶ 12. *See also* § 78u-4(a)(7)(B)(ii). The Court finds these passages sufficient to put members of the class on notice that the damages estimate of Lead Plaintiffs was and is contested by all settling defendants.

Further, while Throenle's assertion that she was not provided with crucial information by the Clerk of the Court is disturbing, the requested information was given to her by Lead Counsel on or around May 23, 2000. Moreover, the notice provided to all class members Lead Counsel's addresses and phone numbers in the event they had any questions about any matter contained in the notice. Notice at 2.

The Court finds that shareholders' access to Lead Counsel, combined with counsel's responsiveness to Throenle's request for documents, demonstrates that objectors had access to all relevant court-filed documents.

All other objections to the notice of settlement are rejected as requiring unreasonable or unnecessary information.

The Court concludes that the Notice of Settlement complied with Rule 23(e) and due process.

2. General Principles of Substantive Analysis

Federal Rule of Civil Procedure 23(e) governs this analysis: the settlement must be fair, reasonable and adequate. The nine-factor *Girsh* test is the guide. *See Girsh*, 521 F.2d at 157. This test directs this Court to conduct (1) "a substantive inquiry into the terms of the settlement relative to the likely rewards of litigation" and (2) "a procedural inquiry into the negotiation process." *General Motors*, 55 F.3d at 796. The Court, however, cannot substitute its concept of an "ideal" settlement for the one presented by the parties: "Significant weight should be attributed 'to the belief of experienced counsel that settlement is in the best interest of the class.' " *Lake v. First Nationwide Bank*, 900 F. Supp. 726, 732 (E.D. Pa. 1995). "Thus, the issue is whether the settlement is adequate and reasonable, not whether one could conceive of a better settlement." *In re Prudential*, 962 F. Supp. at 534 (citing *In re Domestic Air Transp. Antitrust Litig.*, 148 F.R.D. 297 (N.D. Ga. 1993)).

"[C]ourts approving settlements should determine a range of reasonable settlements in light of the best possible

recovery (the nine *Girsh* factors) and a range in light of all the attendant risks of litigation." *See General Motors*, 55 F.3d at 806. Put differently:

> In formulaic terms we agree that "in cases primarily seeking monetary relief, the present value of the damages plaintiffs would likely recover if successful, appropriately discounted for the risk of not prevailing, should be compared with the amount of the proposed settlement." This figure should generate a range of reasonableness (based on size of the proposed award and the uncertainty inherent in these estimates) within which a district court approving (or rejecting) a settlement will not be set aside. The evaluating court must, of course, guard against demanding too large a settlement based on its view of the merits of the litigation; after all, settlement is a compromise, a yielding of the highest hopes in exchange for certainty and resolution.

Id. (citations omitted).

As noted, the Cendant settlement provides for a payment of $2,851,500,000 cash to the class and additional payment to the class from Cendant and the HFS Individual Defendants in the event they recover damages in their suits against E&Y — 50% of any net recovery. The E&Y settlement pays $335,000,000 cash to the class. Before proceeding to the *Girsh* factors, *General Motors* directs the Court to determine the value of the settlement to the class. 55 F.3d at 806-07. The element of uncertainty in the valuation of the Cendant

settlement is the contingent payments to the class by Cendant and the HFS Individual Defendants from any recovery against E&Y. The Court previously refused to rule the HFS contribution "illusory" or "de minimis" but placed no concrete value on it. In their action against E&Y, the HFS Defendants claim losses of over $1 billion. HFS Brf. at 23. Lead Plaintiffs state that these two potential contributions "may prove significant given the extent of damages Cendant and the Individual HFS Defendants are seeking to recover against E&Y." Brf. at 4. The Court recognizes that this recovery is inchoate but once again affirms that it is not "illusory." This does not mean that valuation is impossible, but only difficult. However, as shown below, even before any added value from recovery against E&Y is factored into the evaluation of the settlement, the now calculable settlement of $3.1 billion is "fair, reasonable and adequate."

a. First *Girsh* Factor: Complexity & Likely Duration of Litigation

This factor captures "the probable costs, in both time and money, of continued litigation." *General Motors*, 55 F.3d at 812 (quoting *Bryan v. Pittsburgh Plate Glass Co.*, 494 F.2d 799, 801 (3d Cir. 1974)). Lead Plaintiffs assert (1) the claims presented complex legal and technical accounting issues which would require extensive preparation and in-depth expert testimony; (2) this case is settling long before trial — "[w]ith discovery in its early stages, if Lead Plaintiffs were to press toward a trial, it would be at least one to two years before a trial could begin," Joint Decl. ¶ 131(i); and (3) even if the class recovered at trial, post-trial motions and appeals would likely delay recovery. E&Y adds that an action

against the firm would also involve a substantial investment of time by Lead Plaintiffs.

The Court agrees. To get to the eve of trial against either E&Y or Cendant, the parties would have to engage in a lengthy discovery process. Moreover, discovery would be complicated by the number of defendants, both individual and corporate, which would likely require significant devotion of time and energy by Lead Counsel. Further, the information revealed through discovery would present complex accounting issues necessitating expert review and testimony. In addition, continued prosecution of the class action would lead to further factual disputes. Cendant and E&Y are, in essence, blaming one another for the CUC accounting errors. Lead Counsel would be required to attempt to trace the alleged accounting errors to their source and allocate blame at trial. Lead Counsel would also have to prosecute its claims against all 28 individual defendants and prove their level of involvement in the wrongdoing.

Complex legal issues would also arise: The PSLRA changed the playing field for securities class actions. The Court has already had to address novel legal issues under the statute, such as appointment of Lead Counsel and Plaintiffs. The Court anticipates that continued prosecution of the action would give rise to additional issues not yet addressed by other courts. From this litigation, the Circuit has recently expanded the definition of "in connection with" as used in Section 10(b). *See Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. June 16, 2000, amended Aug. 10, 2000).

Moreover, even if no novel legal issues were presented:

> [T]he litigation would be legally and factually complex and extremely expensive and time-consuming. Class Counsel would require months to consult with additional experts, to prepare trial memoranda, to prepare post-trial memoranda, and to take interlocutory and other appeals. Moreover, if tried, the trial would last for months and would not be completed for years. *See, e.g., Weiss v. Mercedes-Benz of North America, Inc.*, 899 F. Supp. 1297, 1301 (D.N.J.1995) ("Given the crowded state of this Court's calendars, the case would not be tried prior to 1997 [opinion dated May 11, 1995]. It is not unrealistic to predict that, if fully litigated, the present class action would not be concluded before the end of this decade. . . ."); *In re Warner Communications Securities Litigation*, 618 F. Supp. 735, 745 (S.D.N.Y.1985) ("Although much discovery has been conducted, much would remain if the parties were to go to trial.").

In re Prudential, 962 F. Supp. at 536, *aff'd*, 148 F.3d at 317 ("the trial of this class action would be a long, arduous process requiring great expenditures of time and money on behalf of both parties and the court."); *see also In re IKON*, 2000 WL 567104, at *11 (the "inherently complicated nature of large class actions alleging securities fraud" weighed in favor of settlement). It may well be that a realistic trial date cannot be before 2002.

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The post-fairness hearing submission by Duncan does not alter this conclusion. The complexity of plaintiffs' case against E&Y is at least as complex, if not more so, than the case against Cendant.

This factor counsels in favor of settlement approval.

b. Second *Girsh* Factor: The Reaction of the Class

Courts must examine the class reaction to the proposed settlement. Here four class members object to the settlements (one specifically addresses the Plan of Allocation) and two non-class members object. None of the objectors is an institutional investor, though the Davidson objectors had and have significant holdings.

A small percentage of objectors may lead to the inference that the majority of the class "silent[ly] consent[s]" to settlement. *See Weiss*, 899 F. Supp. at 1301, *aff'd*, 66 F.3d 314 (3d Cir. 1995). According to Lead Plaintiffs, 478,000 notices of settlement have been sent and 30,000 claims were filed pre-fairness hearing (50,000 through July 24th). Moreover, only 234 class members opted out by December 27, 1999.

The Court finds the number of objectors minimal in light of the number of notices sent. *See generally Stoetzner v. United States Steel Corp.*, 897 F.2d 115, 118-19 (3d Cir. 1990) (29 objections in a 281 member class indicates class favors settlement); *In re Prudential*, 148 F.3d at 318 (affirming conclusion that class reaction was favorable where 19,000 policyholders out of 8 million opted out and 300 objected).

Moreover, the Court takes as an extremely favorable indicator of class reaction that the proposed settlement was announced *before* the opt-out deadline, yet only 234 potential class members declined to join this action. An additional favorable factor is the absence of institutional investor-objectors which are presumably experienced in responding to settlement notices. Significantly, one large investor, Daystar Partners, an investment limited partnership with over $35 million in losses, has dismissed its individual action and rejoins the class for settlement.

While too much should not be read into low response rates in general, *see General Motors*, 55 F.3d at 813, the lack of objection by those most experienced in securities class actions indicates a favorable class reaction.

This factor counsels in favor of settlement approval.

c. The Third *Girsh* Factor: The Stage of Proceedings

This factor "captures the degree of case development that class counsel have accomplished prior to settlement. Through this lens, courts can determine whether counsel had an adequate appreciation of the merits of the case before negotiating." *General Motors*, 55 F.3d at 813; *see also In re Warner Communications Securities Litig.*, 618 F. Supp. 735, 745 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986). Here the case commenced in April 1998, the Amended Class Action Complaint filed in December 1998 and a proposed settlement announced in December 1999. And this Court has maintained direct supervision throughout. No other judicial officer has been involved.

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In the current case, Lead Counsel submit a detailed explanation of "informal" discovery conducted while the defendants' motions to dismiss were pending (between commencement of the action and July 1999), including: (1) analysis of all public filings, articles and analyst reports concerning CUC, HFS and Cendant, including the analysis of all of CUC's and Cendant's financial statements, restatements, and the Wilkie Farr & Gallagher ("WF&G") and Arthur Andersen ("AA") Reports to the Cendant Audit Committee; (2) investigation, with the assistance of a private investigation firm, of Cendant, each HFS and CUC Individual Defendant, E&Y and the senior E&Y auditors responsible for CUC and CMS audits; (3) interviews of many former CUC, Cendant and E&Y employees; (4) review of documents produced by Cendant, including all documents provided to WF&G and AA in connection with their investigations into Cendant; (5) retention of the accounting firm Marks Peneth & Schron LLP to assist in the above analysis of Cendant's documents.

Once the motions were denied and formal discovery commenced (post-July 1999), Lead Counsel: (6) served document requests and interrogatories on all defendants and served subpoenas on relevant non-parties; (7) reviewed documents produced in response, including all of Cendant's responsive documents, three years of annual and quarterly audit reports provided by E&Y, papers produced by WF&G, and papers produced by Bear Stearns & Co., advisor to HFS in the HFS/CUC merger. Moreover, in preparation for settlement negotiations, Lead Counsel: (8) retained investment banker Lazard Freres & Co., financial consultant Arthur S. Ainsberg, and damages expert Forensic Economics, Inc.

Lazard Freres then: (a) obtained confidential business information from Cendant (the type of information obtained in due diligence in connection with a merger or acquisition); (b) met with senior Cendant financial personnel, including the Chief Financial Officer, and representatives of Merrill Lynch; (c) prepared a detailed five-year model of Cendant's financial condition; (d) developed extensive projections assuming a possible range of settlement amounts; and (e) in May-June 1999, briefed Lead Plaintiffs and Counsel and provided results of its study to Cendant. Lead Counsel further: (9) worked with Forensic Economists to prepare a damages analysis; and (10) reviewed a report prepared by Cendant's damages expert, NERA.

Lead Counsel, in addition to conducting informal and formal discovery, also litigated pretrial motions, including: a motion for clarification of a May 1998 consolidation order, *see In re Cendant Corp. Litig.*, 182 F.R.D. 476 (D.N.J. 1998); the motion for class certification (granted in January 1998); and the motions to dismiss filed by all defendants decided in July 1999, *see In re Cendant Corp. Litig.*, 60 F. Supp. 2d 354 (D.N.J. 1999). Records indicate that they also filed, but stayed, a motion for partial summary judgment of liability against Cendant. *See* 98-1664, Docket No. 150 (Dec. 14, 1998).

Duncan specifically attacks the timing of settlement: "The three felons at Cendant have only begun to cooperate freely with the United States Attorneys' Office." She poses the rhetorical question: "[W]ho will really be surprised when that cooperation leads to direct evidence, or even admissions, of fraud against the E&Y personnel with whom these three

felons worked?" She also states that settlement is premature because not one deposition was taken by class counsel, nor did they review 25 boxes of documents produced by Cendant.

The Court is not persuaded by Duncan's objections. As described, Lead Counsel conducted significant investigation, including review of all documents produced in response to the WF&G/AA investigation. Moreover, Lead Counsel make clear that they have looked at every document, including those which Duncan alleges were not reviewed. Finally, the Court does not adopt Duncan's "wait and see" approach to the E&Y settlement. If that were to happen, significant delay would occur to any recovery by the class against E&Y. Civil depositions of any target of a criminal investigation are stayed and the United States Attorneys' Office has already indicated its disapproval of any ongoing civil action; Lead Counsel have had access to the substance of the recent pleas; SEC enforcement and United States Attorneys' documents do not necessarily support Duncan's contention that given additional time, clear evidence of E&Y's wrongdoing will emerge. And even if so, substantial enhancement of E&Y's proposed payment to the class remains problematic for reasons later discussed.

The record reveals, and the Court finds, that the parties understood the merits of the class action and "could fairly, safely and appropriately" decide to settle the action with Cendant and E&Y. *In re Prudential*, 962 F. Supp. at 538. Counsel conducted extensive discovery, retained and used experts, and litigated pre-trial motions.

This factor counsels in favor of settlement.

d. The Fourth *Girsh* Factor: The Risks of Establishing Liability

The Court considers this factor in order to "examine what the potential rewards (or downside) of litigation might have been had class counsel decided to litigate the claims rather than settle them." *General Motors*, 55 F.3d at 814. Necessarily, the risks of establishing liability vary with the particular defendant. To repeat, the Amended Complaint plead that all defendants violated § 11 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77k, that Cendant violated § 12(a)(2) of the Securities Act, 15 U.S.C. § 77*l*(a)(2), that defendants Walter Forbes, Shelton, McLeod, and Corigliano violated § 15 of the Securities Act, 15 U.S.C. § 77o, that defendants Cendant, Walter Forbes, Shelton, McLeod, Corigliano, Pember, Silverman, Snodgrass, Monaco, Buckman, Scott Forbes, and E&Y violated § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5, that defendants Walter Forbes, Shelton, McLeod, Corrigliano, Pember, Silverman, Snodgrass, Monaco, Buckman, and Scott Forbes violated § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), that defendants Walter Forbes, Shelton, McLeod, Corrigliano, Silverman, Snodgrass, and Buckman violated § 20A of the Exchange Act, 15 U.S.C. § 78t-1, and that Cendant, the HFS Individual Defendants except Scott Forbes and the CUC Individual Defendants except Pember violated § 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) and Rule 14a-9, 17 C.F.R. § 240.14a-9.

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Cendant

With regard to Cendant Corporation, in October 1998, the Court wrote: "Basic liability in this case has been conceded by the major corporate defendant. No one needs to be reminded that it was Cendant's public admission on April 15, 1998 that spawned this litigation." *In re Cendant Corp. Litig.*, 191 F.R.D. 387 (D.N.J. Oct. 2, 1998). This conclusion stands with regard to Cendant's liability to former HFS shareholders for false and misleading statements in the December 1997 Registration Statement. *See* 15 U.S.C. § 77k. While Cendant may dispute this, Lead Plaintiffs, in the brief in support of settlement, maintain "the claims against the company were strong." Brf. at 17. The difficulties of establishing liability against Cendant are relatively easier on the issue of basic liability but increase when its degree of liability is considered — "even if the Class's claims against Cendant were successful, the jury might have found that Cendant bore only a small proportion of the responsibility for the damages suffered by the Class." Brf. at 17 (citing the PSLRA's provision on proportionate liability which prohibits the collection of damages from a defendant in excess of damages actually caused, *see* 15 U.S.C. § 78u-4(f)(3)(A)).

The Court agrees with this assessment. The risk of establishing basic liability against Cendant is not high, the risk increases, however, when the PSLRA's proportionate liability standard is factored into the equation.

In its October 1998 Opinion, the Court also "recognize[d] the need [of the Court and the plaintiff class] to explore the nature and extent of any involvement of the other defendants,

individual and corporate, and the representations made by Cendant's corporate predecessor(s) in 1997 and earlier years." *Id.* This conclusion also remains:

E&Y

E&Y claims that "plaintiffs' ability to prove E&Y's liability for Cendant's fraud is doubtful." E&Y Brf. at 3-4. Lead Plaintiffs also assert that their risk of establishing liability against E&Y is high because: (1) E&Y continues to deny all knowledge of and participation in CUC and Cendant's fraudulent scheme; (2) the AA and WF&G investigation "disclosed many instances in which CUC or Cendant Membership Services employees went to great lengths to conceal from E&Y pertinent information;" and (3) "no one has contended that E&Y knowingly perpetrated the fraud." LP Brf. at 17-18.

To succeed on the Section 10(b) claims against E&Y, the class would have to show at the very least that the auditor was "so reckless that an inference of intent might be drawn." *In re Leslie Fay Cos.*, 871 F. Supp. 686, 692 (S.D.N.Y. 1995). Less or no scienter is needed under Section 11. *See In re Cendant*, 60 F. Supp. 2d at 364. E&Y also possesses a "due diligence" defense under this statute; E&Y may escape liability if it had, "after reasonable investigation, reasonable ground to believe and did believe" its statements were not misleading. 15 U.S.C. § 77k(b)(3).

The level of scienter required by Section 10(b) and E&Y's potential defenses under Section 11 lead the Court to agree that Lead Plaintiffs face significant obstacles to

establish E&Y's liability. Moreover, other courts which have addressed securities class actions against accounting firms also have found the risk of establishing liability high. *See In re Oracle*, 829 F. Supp. at 1183 ("There is no proof, however, that Arthur Andersen [Oracle's auditor] deliberately or recklessly violated any duty it owed to the plaintiffs. In the absence of such proof, it is unlikely that plaintiffs could sustain their claims against Arthur Andersen."); *see also In re Computron Software, Inc.*, 6 F. Supp. 2d 313, 317 (D.N.J. 1998) ("In light of the possibility that Arthur Andersen was intentionally misled by Computron during its audits, the Plaintiff Class might not have been able to establish liability"). Here there would also be the threat, remote or great, that successful litigation by the class would cause E&Y to escape the financial consequences through the bankruptcy window.

Individual Defendants

Of the 28 individual defendants, 18 are outside directors named only as defendants under Sections 11 (Registration Statement) and 14 (Proxy). Each of these outside directors has a due diligence defense which could allow him or her to avoid liability through reliance on the work of experts — E&Y. In addition, the five inside directors of HFS, Silverman, Snodgrass, Monaco, Buckman, and Scott Forbes, also possess the same due diligence defenses with respect to E&Y's certifications of the CUC and CMS financial statements. Moreover, these HFS directors arguably cannot be held liable for any false and misleading CUC statements issued pre-merger — 75% of the class period. Of the remaining individual director-defendants (CUC's inside directors) only

two have been identified as having played any active role in CUC and CMS's fraud, Corigliano and Pember. The WF&G/AA investigation made no finding of participation by Walter Forbes, Shelton, or McLeod.

These defenses accorded to 23 of 28 directors, combined with the difficulties that Lead Plaintiffs face to prove that defendants Forbes (Scott and Walter), Shelton, McLeod, Silverman, Snodgrass, Monaco, and Buckman acted with the requisite level of scienter under Section 10(b), cause the Court to conclude that Lead Plaintiffs faced risk in establishing liability against this group of defendants. Moreover, as with all other defendants, the Court must also consider that the PSLRA requires allocation of proportionate liability. This further complicates Lead Plaintiffs' case against the individual defendants.

In conclusion, this factor varies depending on the defendant but overall weighs in favor of settlement.

e. The Fifth *Girsh* Factor: The Risks of Establishing Damages

Like the fourth factor, "this inquiry attempts to measure the expected value of litigating the action rather than settling it at the current time." *General Motors*, 55 F.3d at 816. As presented by Lead Plaintiffs, total damage to class members ranges between $8.5 and $8.8 billion.[10] *See* Dorkey Affs. Cendant's damages expert and E&Y dispute this amount.

10. Damages were calculated by the expert under Sections 10(b) and 11. The Plan of Allocation awards to each individual plaintiff whichever damages are greater.

(Cont'd)

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(Cont'd)

Section 10(b) damages are "out of pocket" damages. Dorkey Aff. ¶ 42. The PSLRA seeks to limit Section 10(b) recovery solely to what can be considered "out of pocket" loss by setting a statutory framework for the analysis. 15 U.S.C. § 78u-4(e)(1)-(2). To wit:

> (1) Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.
>
> [or]
>
> (2) In any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

Section 11(e) damages are:

> such damages as *shall represent the difference between*

(Cont'd)

Lead Plaintiffs say that proof of damages against all defendants would lead to a "battle of experts." *See In re Greenwich Pharm. Securities Litig.*, No. 92-3071, 1995 WL 251293, at *4 (E.D. Pa. April 26, 1995) ("Because fair value presumably will differ from the stock market price (the latter being inflated by the fraud), expert testimony is almost always necessary to establish the amount — and indeed the existence — of actual damages"); *see also Warner*, 618 F. Supp. at 745 ("[i]n this 'battle of experts,' it is virtually impossible to predict with any certainty which testimony would be credited"). Lead Plaintiffs repeat that proof of damages is further complicated by the proportionate liability restrictions

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> *the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought:* Provided, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable.

15 U.S.C. § 77k (emphasis added); *see also* Dorkey Aff. ¶ 43.

of the PSLRA. E&Y insists that plaintiffs face increased risk in establishing damages against the accounting firm because it is prepared to prove at trial that "the decline in Cendant's stock price following the announcement of the accounting irregularities was largely due to factors on which E&Y had never offered any opinion and conduct in which E&Y was not involved." E&Y Brf. at 13.

The supplemental analysis provided by Lead Counsel in answer to Duncan's additional briefing further illustrates the difficulty of calculating damages caused by E&Y. Initially, the firm is not liable to post-April 15, 1998 purchasers. And to hold E&Y jointly and severally liable, Lead Counsel must be able to prove that the firm committed knowing violations of the securities laws, otherwise E&Y would only be liable for the proportion of damages caused by its conduct. There are numerous individuals and entities who may have caused some part of the shareholder damages. There is also the very real risk that E&Y's vigorous attempt to place all blame on Cendant would succeed at trial.

In sum, this factor weighs in favor of settlement.

f. The Sixth *Girsh* Factor: The Risks of Maintaining the Class Action Through Trial

Under Federal Rule of Civil Procedure 23(a), a district court "may decertify or modify a class at any time during the litigation if it proves to be unmanageable." *In re Prudential*, 148 F.3d at 320. To date, this class has not been unmanageable, but proceeding to trial would always entail the risk, even if slight, of decertification. *See id.* ("Because

the district court always possesses the authority to decertify . . . examination of this factor in the standard class action appear to be perfunctory. There will always be a 'risk' . . ., and consequently the court can always claim this factor weighs in favor of settlement.").

Accordingly, this factor weighs (slightly) in favor of settlement.

g. The Seventh Factor: The Ability of the Defendants to Withstand Greater Judgment

Aside from the cautionary Texaco tale, no supporting financial information has been provided by Lead Plaintiffs, Cendant or E&Y as to the parties' abilities to withstand greater judgment.

However, plaintiffs' failure to evidence that higher judgment could not be sustained will not scuttle a settlement where other factors counsel settlement approval. *See In re IKON*, 2000 WL 567104, at *25 ("The court has no information on this subject [ability to withstand greater judgment] . . . . Consequently, this factor does not weigh in favor of settlement"); *see also Weiss v. Mercedes-Benz*, 899 F. Supp. 1297, 1302 (D.N.J. 1995) (finding that Mercedes could withstand higher judgment but approving settlement); *see generally In re Medical X-Ray Film Antitrust Litig.*, No. 93-5904, 1998 WL 661515, at *5 (E.D.N.Y. Aug. 7, 1998) (approving settlement despite lack of evidence on defendant's ability to withstand higher judgment).

Moreover, at least as far as Cendant is concerned, objective benchmarks support Lead Counsel and Cendant's

stance that sustaining a larger judgment, and possibly even a larger settlement, might prove fatal. Particularly, the significant percentage of Cendant's market capitalization that will be paid to the class — approximately 25-30%. Even more striking is that Lead Plaintiffs' total damages calculation represents approximately 80-95% of market capitalization (depending on market close) — a figure difficult for this Court to imagine Cendant paying without seeking shelter in our bankruptcy laws.

As for E&Y, the Court cannot make any confident determination of the defendant's ability to pay a higher judgment. The Court does note: the settlement is equivalent to payment of $127,000 by every E&Y partner, including the many who had no involvement with Cendant, to the class; Duncan, the only E&Y objector, does not allege that E&Y is capable of paying $6.2 billion — the largest possible amount of damages sustained by pre-April 15, 1998 purchasers; the settlement amount surpasses any audit fees earned by E&Y from CUC; and the amount exceeds E&Y's available insurance coverage.

This factor weighs neither for nor against settlement.

h. The final *Girsh* factors: The Range of Reasonableness in Light of Best Possible Recovery & The Range of Reasonableness in Light of Litigation Risks

"The fact that a proposed settlement may only amount to a fraction of the potential recovery does not, in and of itself, mean that the proposed settlement is grossly inadequate

and should be disapproved." *Warner*, 618 F. Supp. at 745. The percentage recovery, rather "must represent a material percentage recovery to plaintiff" in light of all the risks considered under *Girsh*.

Here the maximum amount of total damages against all defendants is approximately $8.5 billion. *See* Dorkey Aff. The total settlement amount of nearly $3.2 billion from all defendants represents a 36-37% recovery rate by the plaintiff class. This far exceeds recovery rates of any case cited by the parties. *See Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions* 10-11 (1996) (securities settlements range from 9%-14% of claimed damages). *See also In re Prudential Securities, Inc. L.P. Litig.*, MDL No. 1005, 1995 WL 798907 (S.D.N.Y. 1995) (approving settlement of between 1.6% and 5% of claimed damages); *In re Crazy Eddie Securities Litig.*, 824 F. Supp. 320 (E.D.N.Y. 1993) (settlement of between 6% and 10% of damages); *In re Michael Milken & Assocs. Securities Litig.*, 150 F.R.D. 57 (S.D.N.Y. 1993) (7.5%).

Taken separately, the E&Y settlement, according to Lead Counsel's calculations, represents approximately 5.4% of the $6.2 billion in damages sustained by pre-April 15, 1998 purchasers; and 9.25% of the damages if it is assumed that E&Y and Cendant bear equal responsibility for the $6.2 billion. Viewed in the context of securities settlements, this figure is in line with the percentages of recovery described above (between 1.6% and 10% of damages). Viewed in light of recoveries against accounting firms for securities damages, the recovery is large. *Cf. In re Informix Corp. Securities Litig.*, No. 1997-1289 (N.D. Cal.); *In re Waste Management, Inc.*,

No. 1997-7709 (N.D. Ill.) (settlements against accounting firms both for less than 4% of claimed damages). Considering the risks of establishing liability and damages addressed in the evaluation of other *Girsh* factors, the Court concludes that this rate of recovery is fair, reasonable, and not inadequate.

G. Plan of Allocation

To resay, a Plan of Allocation must also be "fair, reasonable and adequate." *See In re Oracle Securities Litig.*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,355 at 90,446 (N.D. Cal. June 18, 1994). The strongest objections to the plan are presented by the Davidsons, who attack the methodology used to create the plan.

Lead Plaintiffs' expert, Frank C. Dorkey, President of Forensic Economics, Inc., uses event study methodology to calculate the losses suffered by shareholders and allocate damages. This study attempts to calculate out-of-pocket damages suffered by shareholders due to Cendant's fraudulent accounting practices. Out-of-pocket damages for shares bought during the class period and held until the end of the period are defined as "the price paid for a security minus the 'true value' of the security on the date of purchase — i.e., the value absent the [artificial] inflation caused by claimed misrepresentations or omissions." Dorkey Aff. III ¶ 6 (unless otherwise noted, all further citations to Dorkey's Affidavit refer to his third submission dated July 19, 2000). For shares bought during the class period and sold before its end, the damages "generally equal the artificial inflation at purchase minus the artificial inflation at sale." *Id.* A summary of the methodology is as follows:

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First, an event study is prepared. This measures the day-to-day changes of share price and isolates times when the disclosure of information is accompanied by a stock price return outside the stock's normal volatility. Aff. ¶ 12 (a "return" is a day-to-day change in share price illustrated as a percentage). This is done by estimating an appropriate market model to measure returns — here the S&P 500 Index was used. *Id.* ¶¶ 12-14 (detailing selection of appropriate market model). Dorkey then examined the stock's volatility on the following dates in 1998: April 16-20th, to measure the impact of the April 15, 1998 disclosure; July 13-14th, for the preliminary announcement of the results of the WF&G/AA Report on July 14th; and August 27-31, for the release which detailed the report and stated that Cendant's income was artificially increased by $500 million. *Id.* ¶¶ 18-28. Trading volume and price changes on these dates exceeded "normal" volume and returns under the market model. For the first event dates, the statistically significant total excess return is -33.65%; the second, -29.67%; and the last, -9.10%. *Id.* Also considered were other news items disseminated to the market between April 15th and August 31st; other shifts in returns in this time span "were likely to have been caused by the highly volatile market prices of Cendant common stock . . . rather than fraud."

Second, a value line is constructed which represents the "true value" of Cendant stock (price absent fraud). Two basic steps are involved: (1) estimate the maximum artificial inflation in the market price of CUC or Cendant common stock, expressed as a percentage of closing market price as of April 15, 1998; and (2) apportion that maximum inflation among the twelve reporting periods between May 31, 1995

and April 15, 1998 when inflated earnings were released. Aff. ¶ 31. Dorkey states that he used the method found in Bradford Cornell & R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 U.C.L.A. L. Rev. 883 (1990) (hereinafter "Cornell & Morgan") to set the value line. This method assumes that "the [trading] price and [true] value of the security move in tandem except on days when fraud-related information is disclosed." *Id.* at 886. Here, there are 8 days where the movement of the security cannot be correlated to actual trading results.

Following Cornell & Morgan, Dorkey "constructed returns" to chart the day-to-day changes of Cendant's price; constructed returns equal actual returns except for the eight days targeted by the event study. For these 8 days, returns are predicted under the market model. Cornell & Morgan at 899.

The series of constructed returns are then used to create the value line. The end of the class period is assumed as the point at which, if plotted on a graph, the market price and the true value of the stock converge — there is no more artificial inflation. Aff. ¶ 33(b). On August 31, 1998, Cendant closed at $11.63. Working backward, the artificial inflation rates are then calculated for the period covered by the correcting disclosures. The true value for August 28th is determined by dividing the value on August 31st ($11.63) by [1 + the predicted return on August 31st (under the market model, -6.8%)]. This yields a true value of $12.47. *See* Cornell & Morgan at 899 (the predicted return under the market model is used for this date because it is one of the

8 days altered by disclosure of fraud). This calculation is repeated for each trading day to determine the true value line through April 15, 1998, the date of the first disclosure of fraud. On that date, the true value of Cendant stock is calculated to be $14.92, *58.1%* of the actual closing price on that date. This date, April 15, 1998, yields the *maximum percentage of artificial inflation.*

Third, the maximum artificial inflation is allocated over the class period. Dorkey relies on the premise that the maximum level of inflation did not remain constant over the class period but gradually increased in the three years over which fraudulent earnings statements were released. Dorkey explains that throughout the class period, the fraudulent releases generally met market earnings expectations, creating a stock price that gradually appreciated with the market model. Aff. ¶ 37. The rate of artificial increase over the class period links the percentage of artificial inflation over the class period (increasing to the maximum percentage of 58.1%) to the actual amount by which each earnings release was overstated over the three year period. This is called the "Ross" approach, developed by David L. Ross of Lexecon, Inc. *Id.* ¶ 38 ("The Ross approach is generally characterized as allocating the maximum artificial inflation in direct proportion to the total cumulative amount of earnings overstatement"); *see also In re California Micro Devices Securities Litig.*, 965 F. Supp. 1327, 1332-33 (N.D. Cal. 1997) (approving settlement with Plan of Allocation developed by Ross).

To illustrate, for the quarter ending April 30, 1995, the percentage of the maximum inflation allocated is equal to a

fraction of: the amount of earnings per share disclosed as overstated for that quarter, or $.04 per share, over the total overstatement of earnings per share of $.61. For the second quarter of 1995, the fraction is expressed as $.08 (the cumulative amount of overstatement for the first and second quarters) over $.61. Aff. ¶¶ 42-43; Ex. 3 (listing complete allocation of inflation percentages over entire class period). The earnings per share used are those reported by Cendant in its 1997 Form 10-K/A. These earnings were reported on a *pooled* basis, i.e., as if CUC and HFS had always operated as one company. Dorkey used pooled figures in part because "the stock price declines . . . occurred in 1998, *after* Cendant was formed." *Id.* ¶ 43. Pooled shares also take into account that a portion of CUC's overvalued assets were, in essence, transferred to HFS shareholders in the merger so that they too were damaged by CUC's fraud. He provides the following hypothetical:

> Facts: Ms. X purchases the only 10 shares in CUC for $1 million. CUC's only asset is Building A with a purported value of $1 million. One year later, CUC merges with HFS. At the time of merger, A was still valued at $1 million. Mr. Y was the sole shareholder of HFS and HFS's only asset was Building B valued at $1 million. In the merger, Mr. B is issued 10 shares of CUC stock. Two months later X and Y learn that A is worthless.
>
> Loss: Ms. X's loss on her 10 shares of CUC stock is $500,000, not her original

$1 million investment in CUC because she transferred 50% of her worthless asset to Y in the merger. Y's losses are also $500,000. He gave up his $1 million investment in HFS for half of a worthless building and half of a building valued at $1 million.

In contrast, using unpooled shares (i.e., CUC shares pre-merger) to calculate X's loss would lead to the following result:

Loss: X's loss would be the entire amount of her CUC investment, or $1 million because damages are the price she paid for her stock minus that stock's true value ($0, for worthless Building A). The shares issued to Y in the merger are ignored. Y's damages are the price he paid for CUC stock (the $1 million of HFS stock surrendered in merger) less the true value of the investment, or $500,000. Paradoxically, the total amount of damages to X and Y using unpooled shares would be $1.5 million, or $500,000 more than the total amount of artificial inflation of Building A.

Thus, Dorkey finds that pooled shares yield the most accurate estimate of damages suffered by both sets of shareholders. *Id.* ¶¶ 43-46.

Fourth, aggregate damages for the class are calculated. To arrive at the total damages, artificial inflation is "applied" to all shares acquired during the class period that were held until at least April 15, 1998, the date of the first corrective disclosure. Aff. ¶ 47. Dorkey did not allocate *any* damage to those who sold before this date because the shares were still artificially inflated at sale, in fact more so than at purchase under Dorkey's methodology. It is impossible to determine the date on which each and every share was purchased or sold, thus Dorkey used a trading model to simulate actual trading. *See id.* ¶ 48 (citing Dean Furbush & Jeffrey Smith, *Estimating the Number of Damaged Shares in Securities Fraud Litigation: An Introduction to Stock Trading Models*, Bus. Lawyer (Feb. 1994)). The model identifies the fraction of each day's volume that represents shares likely purchased and held through April 15th. The model assumes that each share purchased during the class period is more likely to have been traded than the other outstanding shares (the float). *See* Furbush & Smith, *supra*, at 20-22 (indicating that "shares which have not traded recently are less likely to be traded than more recently traded shares"). Using his model, Dorkey estimated that 488.5 million shares were purchased and held beyond the class period and 617.9 million were purchased but sold before the end of the class period. Based on Dorkey's calculation of the total amount of shares traded in the class period, he finds aggregate damage of $8.8 billion.[11]

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11. This calculation factors in the 90-day "bounce back" limitation of the PSLRA, discussed below and at note 10.

Appendix B

H. Objections to this Plan

The Davidsons object to Dorkey's plan. They charge that he:

1. Used restated financial statements of Cendant to construct the value line for the entire class period even though Cendant did not exist until December 1997.

2. Incorrectly applied information in the restated Cendant financial statements for the fourth quarter of 1997 which resulted in a bias in favor of former HFS shareholders.

3. Used unestablished financial methodology; his method "was used in only one other securities fraud case." Dav. Supp. Brf. at 10 (citing *In re California Micro Devices Securities Litig.*, 965 F. Supp. 1327 (N.D. Cal. 1997)).[12]

The Davidsons present an alternative plan which they assert "is both legally and methodologically proper" and should be adopted in place of Lead Plaintiffs' plan.

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12. This objection also serves as a *Daubert* challenge to use of Dorkey as an expert. *See Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993). The Davidsons present two main challenges to Dorkey's methodology: (1) his use of pooled shares and (2) his application of the "Ross" approach. For the reasons stated in the Court's analysis of the Plan of Allocation, the Court finds Dorkey's plan to be methodologically sound.

Appendix B

1. Use of Cendant Data

The Davidsons assert that to measure true out-of-pocket damages, CUC data should have been used to determine the artificial inflation amount for each quarter during the class period. "Because the fraud occurred only at CUC before the HFS merger, a proper damage calculation must assess the true value of CUC shares from May 31, 1995 (the beginning of the class period) until December 17, 1997 (the date of the merger between CUC and HFS resulting in the renamed Cendant)." Dav. Supp. Brf. at 13. They allege that if this method was used, the overstatement in earnings per share for first quarter 1996, for example, would be $.13, not the $.06 calculated under Dorkey's plan. Koehn Aff. Ex. 3. They conclude that the value line calculated under Lead Plaintiffs' plan "yields a hypothetical estimate of the value of a hypothetical Cendant stock . . . . [and] does not yield any estimate whatsoever of the true value of CUC shares at any time during the class period." Dav. Supp. Brf. at 14.

2. Allocation Backward over Class Period

In a related argument, they assert that even if CUC data were used, Dorkey's plan is still flawed because he "took the market decline following Cendant's corrective disclosures, then allocated that decline back through the class period." Dav. Supp. Brf. at 16. They state that this allocation is flawed first because the expert did not exclude other market factors and information which may have also created material price fluctuations during the class period. *See* Cornell & Morgan at 889-90 (cautioning that release of non-fraud related news must be considered). The objectors also state

that Dorkey did not examine for "leakage" of news concerning alleged fraud before Cendant's official releases.

Second, they criticize Dorkey's method of "mechanically" creating a value line linked to Cendant's inflated earnings per share over the three years of the class period. They acknowledge that this method (the Ross approach) was adopted in *Micro Devices*, but distinguish the present situation:

- Micro Devices was not engaged in the "aggressive growth by merger campaign" employed by CUC;

- The fraud in *Micro Devices* spanned only five quarterly reporting periods, not twelve;

- There was no evidence in *Micro Devices*, and none here, that this method produces a reliable estimate of how a *forward*-looking market (as opposed to the price created by the *backward*-looking event study) would have priced the stock if the fraud had been reported during the period.

3. Fourth Quarter 1997 Adjustments

They then maintain that Dorkey's plan is factually erroneous because his calculations for the fourth quarter of 1997 are incorrect. According to Cendant's restated financials, it recognized a reduction in earnings of $283.1 million, described as the "cumulative effect of accounting change." The Davidsons claim that this sum was incorrectly used so as to create higher damages for later purchasers of

Cendant shares and disfavor purchasers from the beginning of the class period. Koehn Decl. ¶ 21.

4. Estimate of Total Damages

They also assert that Dorkey's estimate of total damages is off because he based his estimate of trading volume and percentage of retained shares on the daily trading volume of the New York Stock Exchange. "By focusing only on NYSE transactions, he missed millions of shares, especially retention shares." According to them, this weakness is illustrated because CUC shares issued in connection with acquisitions during the class period are not tracked on the NYSE. Moreover, such shares later sold in registered secondary offerings also do not appear on the NYSE. Taking into account non-NYSE acquisitions and sales, according to the Davidsons, pushes the total calculated class damages from approximately $8.8 billion to over $10 billion.

5. Conflicts

The Davidsons also take issue with Dorkey's plan because it allegedly creates conflicts of interest. Allegedly, the plan's "constant share" approach is biased in favor of those who acquired shares on the open market whereas a "constant dollar" approach would more fairly estimate the losses of those who acquired CUC shares through merger. As explained by Judge Walker in *Micro Devices*, the constant share approach assumes "that the trader would have purchased the same number of [CUC] shares if the fraud had never occurred," and the constant dollar approach assumes "that the trader would have spent the same amount of money

on the company's shares in the absence of fraud." *Micro Devices*, 965 F. Supp. at 1333-34. The Davidsons contend their investment decisions were based not on the number of CUC shares received in merger, but on the dollar value of the shares. They conclude, "a final Plan of Allocation must at least consider an adjustment for constant dollar versus constant value approach for retention holders who acquired shares in negotiated corporate transactions, or else it will foster an irreconcilable conflict among Class Members." Dav. Supp. Brf. at 26.

6. Section 11

Finally, the Davidsons contend that the plan fails to consider Section 11 damages for those who acquired CUC shares under other registration statements. According to the Davidsons, this makes the plan fundamentally unfair under Rule 23.

As said, the Davidsons urge the Court to accept the Plan of Allocation submitted by Dr. Michael F. Koehn. They state that a court considering settlement may modify a plan of allocation without re-noticing the class. *See Beecher v. Able*, 575 F.2d 1010 (2d Cir. 1978). They add that where, as here, the settlement notice reserves to the court the right to modify a plan, those who fail to object to the initial plan have waived their right to object to an alternative plan as well. *See Curtiss-Wright Corp. v. Helfand*, 687 F.2d 171, 173 (7th Cir. 1982).

I. Response and Analysis

In answer, Lead Plaintiffs defend Dorkey's plan. They submit expert testimony of Roman Weil, Professor of

Accounting at the Graduate School of Business of the University of Chicago and founder of the school's Directors' College, which educates members of corporate boards of directors.[13] Weil declares that the crux of the disagreement between the Davidsons and Lead Plaintiffs is the use of pooled shares in Dorkey's analysis. In fact, he states that, except for Koehn's adjustment for unpooled shares, the alternative plan of allocation is nearly identical to Dorkey's. Ex. RLW-1 (green graph line). He claims that the use of pooled shares is necessary where a company acquires assets it later finds to be tainted by fraud. The pooling of interests recognizes that post-merger, HFS shareholders carry part of the loss suffered by the CUC shareholders. Put another way, once the merger occurred, CUC shareholders' "losses" from overvalued shares were no longer borne solely by CUC shareholders but by HFS shareholders as well. RLW Aff. at 5, lns. 160-78.

Lead Plaintiffs refer to the Ms. X/Mr. Y example offered by Dorkey (Aff. ¶¶ 43-45) where the damage calculation using unpooled shares "provides a total of $1.5 million in damages, which is $500,000 more than the total amount of artificial inflation of $1 million." They assert that use of unpooled shares to calculate damages ignores the requirement of Section 10(b) that injured parties recoup only damages actually caused by fraud and provides a windfall to original shareholders of the overvalued company. *See Micro Devices*,

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13. The Court notes that on July 31, 2000, the Davidsons requested exclusion of Weil's affidavit as "inadmissible hearsay" which contains "no independent analysis." The Court finds that Weil is qualified to submit his sworn opinion regarding the Plan of Allocation and sees no reason to exclude his statement.

965 F. Supp. at 1336 (cautioning against awarding damages "unrelated to any alleged fraud and doing so at the expense of innocent shareholders").

The Court agrees with Lead Plaintiffs that pooled shares are preferred in a situation where a contaminated company acquires assets untainted by fraud during the class period. CUC acquired not only HFS, but other smaller companies between 1995 and 1998, each time "diluting" the damages to earlier shareholders from its fraud by spreading it to newer shareholders. The Ms. X/Mr. Y hypothetical, while simplistic, illustrates this principle and explains how when unpooled shares are used damages actually exceed those traceable to the fraud. Conversely, the Davidsons' plan keeps damages linked to CUC's fraud with the earlier class purchasers (before and during CUC's spate of acquisitions) and does not recognize that their damages were partially alleviated by the acquisition of untainted companies. Dorkey's plan, to the extent that it uses pooled shares to created the "true value" line to determine out-of-pocket damages under Section 10(b), is fair to the entire class. The fairness of using pooled shares over unpooled shares is supported by additional expert testimony. Weil Aff. at 5, lns. 160-82. Because of these reasons, the Court finds the Dorkey pooled shares method to be fair and preferable to the method advanced by the objectors.

1. Confounding or Leaked Information

Lead Plaintiffs assert that the Davidsons' contention that Dorkey did not examine other market information is baseless; Dorkey represents that he examined all news items disclosed

to the market between April and December of 1998 for signs of leakage or confounding (non-fraud) information. Aff. ¶¶ 28-29. And he examined the market return rates throughout the entire period to determine periods of statistically significant returns.

The Court finds that this objection has no factual basis and is not justified.

2. Looking Backward

The Davidson's assert that the maximum rate of artificial inflation — 58.1% — should not be allocated backward through the class period. Lead Plaintiffs remark that Cornell & Morgan, the text relied upon by both Dorkey and Koehn, the Davidsons' expert, explicitly directs such an allocation. Cornell & Mogan at 899 ("Use the series of returns constructed . . . to calculate the value line backwards in time . . . ."). Plaintiffs also remark that despite this objection, the Davidsons' own expert used the same 58.1% inflation rate allocated back over the class period.

Lead Plaintiffs also assert that allocation of inflation "forward" should only be done, if at all, in cases where statistically significant excess returns are caused by misleading disclosures when issued. No significant price or volume swings were caused by the fraudulent earnings reports over the three years they were issued because Cendant was generally meeting the market's earnings expectations for this period. The fraudulent results were no surprise when released; statistically significant returns only occurred once the market was informed that the previous returns were inflated — that is, after April 15, 1998.

Appendix B

The Court finds inexplicable that the Davidsons object to a method used by their own expert to determine artificial inflation rates throughout the class period. *See generally* Koehn Decl. ¶ 25 ("Using information revealed by Mr. Dorkey's event study (i.e., the total stock price decline of 58 percent) . . . ."); RLW-1 (true value lines similar if Koehn's analysis altered for pooled shares). It is unchallenged that the reverse allocation used by Dorkey forms an integral part of the event study methodology set out in Cornell & Morgan. The Court finds compelling the factual circumstances surrounding the release of overstated financials — here no statistically significant returns are posted up until the initial correcting disclosure; the market had no reason to react to artificial inflation because its expectations were consistently met until April 15, 1998.

3. Ross Approach

Lead Plaintiffs maintain that criticism of the Ross approach is unfounded. Particularly, they defend the use of cumulative earnings per share overstatement to determine the percentage of inflation attributable to each quarter during the class period. Initially, Lead Plaintiffs state the approach was approved by the *Micro Devices* court:

> Based on the identified inflationary events and corrective disclosures, the plan of allocation pays damages equal to the amount by which per share inflation on the purchase date exceeded that on the sale date. Retention plaintiffs receive an amount equal to the per share inflation on the date of their purchase. This method allocates the

> settlement proceeds in rough proportion to the damages actually suffered by members of the class.

965 F. Supp. at 1333.

They next argue that the factual differences relied on by the Davidsons to distinguish *Micro Devices* are insignificant.

The Davidsons contend that CUC then Cendant was a different company from Micro Devices because CUC/Cendant engaged in an aggressive growth-by-merger campaign over the class period. Lead Plaintiffs respond that "[t]o the extent that it matters at all, CUC's aggressive growth campaign was properly considered by Professor Dorkey through his use of pooled shares, which accounts for the dilutive effect of shares issued during the class period." Rep. Brf. at 17. They add that Dorkey also followed the suggestion of Roman Weil's article, *The Role of Accountant as Expert*, cited in Koehn's declaration at 7 n.2, to perform regression analyses to test the validity of his methodology. Dorkey Aff. III ¶ 14 n.12 ("Dr. Koehn challenges my use of an event study because Cendant was undergoing significant changes in its business activities. This criticism is resolved by the results of various regression analyses I performed, which estimated that Cendant's beta was fairly stable before and throughout the class period.").

Lead Plaintiffs then argue that the differences in class period duration — between five quarterly earnings releases in *Micro Devices*; and Cendant, twelve — is irrelevant. No study is offered for the Davidsons' contention that event study

methodology should be confined to short class periods. Further, Lead Plaintiffs point out that the Cendant event windows were fewer and shorter in duration than the windows in *Micro Devices* — *Micro Devices* had five windows, Cendant only three (linked to the April, July and August releases).

The Court has examined *Micro Devices*, its summary and use of the Ross approach, and the expert affidavits submitted by both sides: The circumstances of *Micro Devices* are not inapposite; the increase from five quarterly overstatements to twelve does not warrant disapproval of the Ross approach or event study methodology. Here there were actually fewer "events" (correcting disclosures) to create statistically significant returns. The Davidsons' criticism that the rapidly-changing CUC then Cendant was a different company from the static Micro Devices is, as illustrated by the earlier Ms. X/Mr. Y hypothetical, allowed for by the use of pooled shares which factor in CUC's acquisitions over the class period. The Court finds their objection to be without merit and the Ross use of cumulative earnings per share reasonable and appropriate to these circumstances.

4. Fourth Quarter 1997 Alleged Errors

Lead Plaintiffs assert, in response to the objection that Dorkey incorrectly calculated earnings per share for the fourth quarter of 1997, that the difference in earnings can be traced to Cendant's restatement of $283.1 million in that quarter caused by what it called an "accounting error." Dorkey included this amount as the fraudulent overstatement because Lead Plaintiffs' Amended Complaint pleads that the adjustment was fraud-related. Amended Compl. ¶¶ 58, 73-76.

The Court concludes that this calculation is fair given that the $283.1 million must be accounted for under the Amended Complaint.

5. Constant Share/Constant Dollar

Lead Plaintiffs argue that the Davidsons' objection that a constant dollar approach should have been used is based entirely on conjecture:

> The "bust out" provision in the DAI-CUC merger agreement *would have* permitted the Davidson Interests to command a much more favorable exchange ration . . . . They *would have* received many, many more shares in the transaction . . . . They *would likely have sold* the same percentages of their holdings . . . .

Dav. Supp. Obj. at 25. Aside from these speculations about how they may have acted if the fraud were known in 1996, Lead Plaintiffs contend "[t]he Davidsons offer no rationale for treating class members differently [by using constant dollar for merger acquisitions and constant share for all other purchasers], when both methods may be used for all class members notwithstanding the manner in which they purchased or acquired their shares." They conclude "[t]he Davidsons' approach would create conflict where none exists." Brf. at 19. No other merger-acquired shareholder presents a similar objection.

The best description of the constant dollar/constant share difference is contained in *Micro Devices*, 965 F. Supp. at

1333-1335. There the court favored the constant dollar approach but nevertheless approved a plan based on constant share calculations. *Id.* It concluded "[t]he parties appear to have selected the constant shares method for the sake of simplicity or a matter of routine, not out of a design to advantage certain class members or the defendants at the expense of other class members" and declined to delay payment of claims based on this objection. *Id.* at 1335.

Such are our circumstances. The Davidsons present no evidence that the plan seeks to devalue merger-acquired shares through use of the constant share method. Compelling is the recognition that while a large number of Cendant shareholders were created through merger of other companies into CUC — e.g., DAI or HFS — the Davidsons are the only ones who allege that such shareholders should be treated differently. To repeat, a Plan of Allocation need not be, and cannot be, perfect. The Court will not invalidate the Plan of Allocation where certain shareholders, seeking advantageous treatment, fail to demonstrate that on the whole the plan is unreasonable. As explained by Lead Plaintiffs, the plan is reasonable.

6. Section 11

Lead Plaintiffs attack the Davidsons' argument that those who acquired shares in mergers other than the HFS merger should be entitled to Section 11 damages: "having neglected to opt out of the Class, they are compelled to live with the allegations of the Amended Complaint. The only [Section 11] claims alleged in the Amended Complaint were on behalf of former HFS shareholders." Brf. at 20. Plaintiffs add that

even if Section 11 damages were to be assessed to the Davidsons' shares, the Davidsons' Section 10(b) loss amounts are greater.

The Court agrees. Damages may not be allocated for claims not plead. Further, there is no showing that damages from Section 11 claims, if permitted, would be greater than plead Section 10(b) compensation.

7. Aggregate Damages

Lead Plaintiffs next address the Davidsons' objection that the aggregate number of damaged shares was incorrectly calculated. They recognize that the trading model used to estimate damaged shares is just that — a model: "Because this is a *model*, it will not replicate specific actual trades, like the Davidsons' CUC stock sales; indeed the model may overstate activity on some days during the Class Period, and understate activity on other days." Brf. at 22. They go on to assert that "trading models are accepted as providing reasonably accurate predictions of trading activity over a period of time and are customarily used to estimate trading activity for the purposes of calculating damages in securities fraud cases." *See, e.g.*, Furbush & Smith, *supra*, at 18-22. And even if this objection were sustained, it only affects Lead Plaintiffs' aggregate damage number of $8.8 billion with no impact on the Plan of Allocation, which does not use trading volume. Brf. at 22-23, 23 n.10.

The Court agrees with Lead Plaintiffs. The use of trading models is accepted to create an estimate of aggregate damages. The Davidsons have given no other reason to

disregard Dorkey's conclusion other than it is based on a *model.* Their objection is rejected.

8. Koehn's Plan

Finally, Lead Plaintiffs attack Koehn's Plan of Allocation because:

- Dorkey's plan is fair, reasonable and adequate and need not be scrapped;
- Koehn's plan is "deliberately constructed to provide the Davidsons with windfall profits" through the use of unpooled shares;
- Koehn's plan explicitly violates the PSLRA's damage calculation limitation, *see* Koehn Decl. ¶ 6;
- Before two "patches" are added to the calculations,[14] Koehn's plan yields the irrational result that on certain trading days the true value of CUC/Cendant stock is *less than zero.*

The Court recognizes that the PSLRA contains an express limitation on the calculation of damages under Section 10(b). Under the statute, there is what is alternatively referred to as

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14. According to Lead Plaintiffs, (1) Koehn limits his calculated loss in market value to the market value or less when his calculations reveal a drop larger than market value; (2) he sets as a further limit that true value cannot be less than .67 of net book value. Thus, whenever his method results in daily true value of zero or less, the value is reset to .67 of net book value.

a 90-day "look back" or "bounce back" window. 15 U.S.C. § 78u-4(e)(1) mandates that:

> in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security *during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.*

(Emphasis added.) Here Koehn states that he did not apply this provision. This admission proves fatal to any attempt to have this Court adopt Koehn's plan which admittedly ignores the PSLRA mandate. In the absence of persuasive reasons, the Court is also reluctant to adopt a plan that reveals a negative "true value" of CUC shares for certain trading days during the class period

J. Conclusion

The settlements and Plan of Allocation are approved.

s/ William H. Walls
William H. Walls, U.S.D.J.

Dated: August 14, 2000

Appendix B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Civ. No. 98-1664 (WHW)

IN RE CENDANT CORPORATION
SECURITIES LITIGATION

ORDER

Pursuant to Federal Rule of Civil Procedure 23(e), Lead Plaintiffs, the New York State Common Retirement Fund, the California Public Employees' Retirement System and the New York City Pension Fund, move, on behalf of themselves and the Class, for (i) approval of two settlements, one with Cendant Corporation and the HFS Individual Defendants named below, and one with Ernst & Young LLP ("E&Y"), and (ii) approval of the Plan of Allocation of the Net Settlement Fund. The Cendant settlement provides for a payment to the class of $2,851,500,000 in cash, provides for additional payment to the class from Cendant and the HFS Individual Defendants in the event they recover damages in their suits against E&Y — 50% of any recovery — and imposes certain corporate governance changes on Cendant Corporation. The E&Y settlement provides for a cash payment of $335,000,000 to the class. The Court having conducted a fairness hearing, heard the argument of counsel for Lead Plaintiffs and counsel of objectors, and having now expressed its reasons in the accompanying Opinion:

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It is on this 14th day of August, 2000,

ORDERED that the Cendant settlement in the amount of $2,851,500,000 and 50% of any recovery by Cendant and the HFS Individual Defendants against E&Y, plus corporate governance changes detailed in the Settlement Agreement, is approved; it is further

ORDERED that the E&Y settlement in the amount of $335,000,000 is approved; and it is

ORDERED that the Plan of Allocation of the Net Settlement Fund is approved.

s/ William H. Walls
William H. Walls, U.S.D.J.

APPENDIX C — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY APPROVING LEAD PLAINTIFFS' PLAN OF ALLOCATION OF NET SETTLEMENT FUND DATED AUGUST 14, 2000 AND FILED AUGUST 15, 2000

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Master File No. 98-1664 (WHW)

This document relates to:
All Actions Except the Prides Action (No. 98-2819)

In re:

CENDANT CORPORATION LITIGATION

ORDER APPROVING LEAD PLAINTIFFS' PLAN OF ALLOCATION OF NET SETTLEMENT FUND

On this 14th day of August, 2000, a hearing having been held before this Court to consider: (1) the Lead Plaintiffs' Plan of Allocation for Net Settlement Fund (the "Plan") for distribution of the Net Settlement Fund to be established as a result of the Settlements in this Litigation; and (2) the fairness and reasonableness of the Plan to the Class Members;

And it appearing that a notice of the hearing, and a description of the Plan, substantially in the form approved by the Court was mailed to all persons and entities reasonably identifiable, who purchased or otherwise acquired Cendant and CUC securities, including call options on Cendant common stock but excluding PRIDES, during the Class

Period, except those persons and entities excluded from the definition of the Class, as shown by the records of Cendant and as further identified through the mailing of the Notice of Pendency of Class Action and the Summary Notice of Pendency of Class Action, pursuant to earlier order of the Court, at the respective addresses set forth in such records;

And it appearing that a summary notice of the hearing substantially in the form approved by the Court was published in *The Wall Street Journal*, *The New York Times* and over the PR Newswire, pursuant to the specifications of the Court;

And the Court, having considered all matters submitted to it at the hearing and otherwise having determined the fairness and reasonableness of the Plan;

And, it appearing that the Plan is fully supported by documents and affidavits showing the reasonableness of the Plan and its fairness and reasonableness to the Class Members, considering the market prices of Cendant and CUC securities, including call options on Cendant common stock, and the damages study conducted by Lead Plaintiffs' damages expert;

NOW, THEREFORE, IT IS HEREBY ORDERED THAT:

1. The proposed Plan of Allocation of Net Settlement Fund is APPROVED. Lead Plaintiffs are authorized and directed to utilize the Plan as the basis for calculating the Proofs of Claim submitted by Class Members in connection with the Settlements in this Litigation.

2. The Court hereby finds and concludes that the Plan is fair and reasonable to Members of the Class of persons and entities who purchased or otherwise acquired publicly traded securities of CUC and Cendant, including call options on Cendant common stock, except for PRIDES, and who were damaged thereby. The Court further finds that the Plan is rationally based on the market prices of CUC and Cendant securities, including call options on Cendant common stock, during the Class Period and on the damages study prepared by Lead Plaintiffs' expert consultant, and is further consistent with the Opinions and Orders previously issued by the Court with respect to the claims asserted by Lead Plaintiffs in the Litigation.

3. The finality of the Judgments entered with respect to the Settlement between Lead Plaintiffs and Cendant Corporation and Certain Other Defendants, and the Settlement between Lead Plaintiffs and Ernst & Young LLP, shall not be affected in any manner by this Order, or any appeal from this Order approving the Plan. However, Cendant shall have no obligation to make any payment into the Escrow Account except as specifically provided in ¶ 8(d) of the Stipulation between and among Lead Plaintiffs and Cendant Corporation and Certain Other Defendants. There shall be no distribution of any of the Settlement Amounts to any Class Member until this Order becomes final, and is either affirmed on appeal and/or is no longer subject to review by appeal or certiorari, and the time for any petition for rehearing, appeal or review, whether by certiorari or otherwise, has expired.

4. The notice described herein provided the best notice practicable under the circumstances. Said notice provided

due and adequate notice of these proceedings and the matters set forth therein, including the Plan of Allocation, to all persons entitled to such notice, and said notice fully satisfied the requirements of Rule 23 of the Federal Rules of Civil Procedure and the requirements of due process.

5. There is no just reason for delay in the entry of this Order Approving Plan of Allocation of Net Settlement Fund, and immediate entry of this Order by the Clerk of the Court is expressly directed pursuant to Rule 54(b) of the Federal Rules of Civil Procedure.

DATED: 14 August 2000

s/ William H. Walls
WILLIAM H. WALLS, U.S.D.J.

APPENDIX D — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY DATED AUGUST 8, 2000 AND FILED AUGUST 9, 2000

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Consol. Civ. Action No. 98-1664

IN RE CENDANT CORPORATION
SECURITIES LITIGATION

This document relates to:

WILLIAM P. YEAGER and VIRGINIA I. YEAGER,
Co-Trustees of the William P. Yeager
and Virginia I. Yeager Trust,

Plaintiffs,

v.

CENDANT CORPORATION, et al.,

Defendants.

OPINION

Walls, United States District Judge

INTRODUCTION

Plaintiffs William P. and Virginia I. Yeager, co-trustees of the William P. Yeager and Virginia I. Yeager Trust

(collectively "Yeager plaintiffs"), move for partial summary judgment that defendant Cendant[1]: 1) violated Section 11 of the Securities Act of 1933 ("Securities Act") and is liable to plaintiffs for $15,849,680.92 plus interest (Count 1); 2) violated Section 12(a)(2) of the Securities Act (Count 5); 3) violated Rule 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder (Count 7); and 4) violated Section 14a of the Exchange Act and Rule 14a-9 promulgated thereunder (Count 12). The court heard oral argument on July 31, 2000.

The facts underlying this action are fully set forth in this court's December 13, 1999 opinion which granted in part and denied in part defendants' motion to dismiss the Yeagers' complaint. *See* 190 F.R.D. 331 (D.N.J. 1999). Briefly, the Yeagers acquired 1,109,854 shares of common stock of defendant Cendant Corporation in exchange for 461,847 shares of HFS Incorporated in the December 1997 merger of CUC International, Inc. and HFS. Soon after the oft-discussed April 1998 mea culpas by Cendant, *see e.g. In re Cendant Corp. Litigation*, 182 F.R.D. 144 (D.N.J. 1998), and 60 F. Supp. 2d 354 (D.N.J. 1999), the Yeagers began to sell off their Cendant holdings; they had fully divested their Cendant shares by July 1998. Yeager Br. at 12.

These plaintiffs' securities law claims, addressed in this opinion, arise from public documents generated by CUC, HFS and Cendant: 1) a Registration Statement filed by HFS and CUC with the SEC on August 28, 1997; 2) a Joint Proxy Statement/Prospectus, also filed by HFS and CUC with the

1. Plaintiffs' complaint named numerous defendants, but by this motion, the Yeagers move against only the corporation Cendant.

SEC on August 28, 1997, and distributed to HFS shareholders, including plaintiffs, on August 29, 1997. The Yeagers also rely on documents created after the disclosures of fraud, during the investigation and litigation that followed: 3) an Audit Report, filed with the SEC in Cendant's August 28, 1998 form 8-K, presented to Cendant's Audit Committee by the law firm Willkie Farr & Gallagher and accounting/ consulting firm Arthur Anderson LLP; and 4) Cendant's cross-claim and amended cross-claim against CUC's long-time auditors Ernst & Young LLP, filed August 19, 1999 and June 19, 2000, respectively.

DISCUSSION

1. *Standard for Summary Judgment*

Summary judgment is appropriate where the moving party establishes that "there is no genuine issue as to any material fact and that [it] is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). A factual dispute between the parties will not defeat a motion for summary judgment unless it is both genuine and material. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). A factual dispute is genuine if a reasonable jury could return a verdict for the non-movant and it is material if, under the substantive law, it would affect the outcome of the suit. *See Anderson*, 477 U.S. at 248. The moving party must show that if the evidentiary material of record were reduced to admissible evidence in court, it would be insufficient to permit the non-moving party to carry its burden of proof. *See Celotex v. Catrett*, 477 U.S. 317, 318 (1986).

Once the moving party has carried its burden under Rule 56, "its opponent must do more than simply show that there is some metaphysical doubt as to the material facts in question." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). The opposing party must set forth specific facts showing a genuine issue for trial and may not rest upon the mere allegations or denials of its pleadings. *See Sound Ship Building Corp. v. Bethlehem Steel Co.*, 533 F.2d 96, 99 (3rd Cir. 1976), *cert. denied*, 429 U.S. 860 (1976). At the summary judgment stage the court's function is not to weigh the evidence and determine the truth of the matter, but rather to determine whether there is a genuine issue for trial. *See Anderson*, 477 U.S. at 249. In doing so, the court must construe the facts and inferences in the light most favorable to the non-moving party. *See Wahl v. Rexnord, Inc.* 624 F.2d 1169, 1181 (3rd Cir. 1980).

2. *Section 11*

Plaintiffs request summary judgment, as to both liability and damages, under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k(a). Under Section 11, purchasers of registered securities may sue enumerated individuals for materially false or misleading information included in, or the omission of material information from, the registration statement. Plaintiffs may meet their prima facie burden by showing only a material misstatement or omission. Notably, "[l]iability against the issuer of a security is virtually absolute," *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983), so that plaintiffs need not demonstrate scienter. *Id.*; *In re Cendant Corporation Litigation*, 60 F. Supp. 2d 354, 363 (D.N.J. July 27, 1999).

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Plaintiffs contend that misstatements in the August 1997 registration statement, particularly concerning CUC's fraudulently reported earnings, "would have been viewed by the reasonable investor as having altered the 'total mix' of information made available," and are therefore material as a matter of law. *See In re Donald J. Trump Casino Sec. Litigation-Taj Mahal Litig.*, 7 F.3d 357, 369 (3rd Cir. 1993) (citation omitted). Though materiality is "a relative concept," *id.*, Cendant does not deny that the representations in the registration statement were material, and this court finds no reason to reject the parties' assertions on the point.

Recognizing the "relatively minimal burden" on a Section 11 plaintiff, *see Herman & MacLean*, 459 U.S. at 382, Cendant apparently concedes liability. *See* Cendant Br. at 11 (arguing that plaintiffs' motion for summary judgment on Section 11 claims should be denied — but only to the extent plaintiffs seek "rote application" of the statutory damages measure). However, the corporation invokes the statutory defense of "negative causation," *see* 15 U.S.C. § 77k(e). Under this provision, "if the defendant proves that any portion or all of [plaintiffs'] damages represents other than the depreciation in value of such security resulting from [the misstatements or omissions in] the registration statement," its liability is reduced or eliminated. *Id.* By the plain language of the statute, defendant bears the burden of proof on this affirmative defense. *Akerman v. Oryx Communications, Inc.*, 810 F.2d 336, 341 (2nd Cir. 1987); *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 65 F.3d 1044, 1048 (2nd Cir. 1995).

The Yeager plaintiffs calculate Section 11 damages according to 15 U.S.C. § 77k(e), which allows recovery of

"the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and . . . (2) the price at which such security shall have been disposed of in the market before suit." Plaintiffs evidence that they exchanged 461,847 shares of HFS common stock, worth $35,764,277.06 at closing on the day before the merger; in return, they received 1,109,864 CUC/Cendant shares and $16.05 cash. Yeager Decl. ¶¶ 2-3, Yeager Appendix Exhs. 14, 16, 17. After Cendant's disclosures of fraud, the Yeagers sold all of their Cendant stock between May 19 and July 15, 1998, for total proceeds of $19,914,580.09. Yeager Decl. ¶ 4, Yeager Appendix Exh. 18. Plaintiffs request $15,849,680.92 in damages, which represents the difference between the value of the HFS shares they traded in, and the selling price received in May and June 1998. They also seek prejudgment interest. *See Feather v. United Mine Workers of America*, 711 F.2d 530, 540 (3rd Cir. 1983).

Cendant seeks to reduce that figure, relying on the declaration of financial economist Dr. Marcia Kramer Mayer. Dr. Mayer, a specialist in securities and financial economics, opines that plaintiffs have "fail[ed] to account for the fact that a substantial portion of the decline in Cendant's stock price between the time of the acquisition of their shares and the times of their sales of these shares was attributable to factors other than the accounting irregularities and errors." Mayer Decl. ¶ 9. Her statistical "event study," which assesses the reaction of Cendant's stock price to each public disclosure of accounting irregularities, purports to evaluate the amount of artificial inflation per share (the portion of the price attributable to the alleged misstatements) on various dates. *Id.* ¶¶ 19-23. For example, Dr. Mayer finds that Cendant's

April 15, 1998 disclosure reduced artificial inflation to $6.40 (down from $13.39 at the time of the merger), and that the company's July 14, 1998 disclosure eliminated all remaining artificial inflation. *Id.* ¶ 25 and Exh. 7. She concludes that, though the Yeager plaintiffs sustained actual losses of between $9.63 to $16.50 on their Cendant sales, only $6.99 of the May and June 1998 losses, and $13.39 of the July losses, are attributable to misstatements in Cendant's financials. "The remainder is attributable to other factors, such as (but not limited to) changes in general market and industry conditions." *Id.* ¶ 26 and Exh. 7.

Such statistical evidence is sufficient to create a triable issue of fact on the negative causation issue, as to the amount of appropriate damages. *See, e.g., Akerman*, 810 F.2d at 342. Whether Cendant can prove its assertion that causes other than the misstated financials contributed to plaintiff's losses remains to be seen at trial. *See Collins v. Signetics Corp.*, 605 F.2d 110, 115 (3rd Cir. 1979) (affirming jury verdict for defendant based on corporate defendant's expert testimony that various economic and political factors caused a market decline, including "high interest rates, inflation, the war in the Middle East, Watergate, Vice President Spiro Agnew's resignation, a large verdict against International Business Machine Corporation, the oil embargo and subsequent long lines at gasoline stations, closing of large automobile plants, President Nixon's resignation, United States-Soviet confrontations, and shortages and fears of shortages in general"), *overruled on other grounds, Pinter v. Dahl*, 486 U.S. 622, 644 (1988).

Yet, as noted by plaintiffs, Cendant's own expert admits that at least some of the Yeagers' losses, $11,661,078.96,[2] can be traced directly to the registration statement. Mayer Decl. ¶ 26. Because Cendant does not dispute its Section 11 liability, plaintiff's request for partial summary judgment as to liability is granted; because Cendant concedes $11,661,078.96 in damages, plaintiffs are entitled to summary judgment as to that amount on their Section 11 claims.

3. *Section 12(a)(2)*

Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77*l*(a)(2), provides:

> Any person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus . . . which includes an untrue statement of material fact . . . (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable . . . to the person purchasing such security from him . . . for damages if he no longer owns the security.

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2. In their briefs, plaintiffs calculate defendant's admitted damages at $11,812,117.88, purportedly based on Dr. Mayer's calculations. At oral argument, defendant challenged that figure, admitting only $11,661,078.96. Plaintiffs did not respond; the court therefore accepts the lower figure.

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To warrant summary judgment, plaintiffs must establish a lack of disputed issues concerning Cendant's offering of shares by means of a prospectus which contained material misstatements of fact. *In re MobileMedia Securities Litig.*, 28 F. Supp. 2d 901, 933 (D.N.J. 1998). The legal standard for materiality under this provision is the same as under Section 11. *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d at 369.

The Yeagers contend that they have evidenced these elements: they were offered stock by means of the Joint Proxy Statement/Prospectus, and the Joint Proxy Statement/ Prospectus contained material misstatements concerning CUC's financial performance for the years ended January 31, 1996 and January 31, 1997, and the quarters ended April 30, 1997 and July 31, 1997. Yeager Br. at 31. Cendant does not challenge these assertions. *See, e.g.*, Cendant Response to Plaintiffs' First Set of Requests for Admission, Yeager Exh. 4 ¶¶ 33, 40 ("Cendant admits that the Joint Proxy Statement was inaccurate in certain material respects . . .").

Summary judgment is granted to the Yeager plaintiffs on their claims under Section 12(a)(2) of the Securities Act.

4. *Section 10(b) and Rule 10b-5*

The parties debate Cendant's liability under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, which make it illegal:

> (a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5. To prove such a claim, plaintiffs must show that Cendant, in connection with the purchase or sale of a security, (1) misrepresented or omitted (2) a material fact (3) with knowledge or recklessness (scienter), and (4) reasonable reliance by plaintiffs with (5) consequent injury. *In re Advanta Corp. Securities Litig.*, 180 F.3d 525, 537 (3rd Cir. 1999); *see also Kennilworth Partners L.P. v. Cendant*, 59 F. Supp. 2d 417, 427 (D.N.J. Aug. 10, 1999).

Here the major disputed element is that of scienter. Plaintiffs contend that Cendant has admitted facts which incontrovertibly establish this element, relying on the doctrine of judicial admissions: "A party's assertion of fact in a pleading is a judicial admission by which it normally is bound throughout the course of the proceeding." *Schott Motorcycle Supply, Inc. v. American Honda Motor Co.*, 976 F.2d 58, 60 (1st Cir. 1992). A party will be held to its unambiguous and plainly worded statements, "deliberately drafted by counsel for the express purpose of limiting and defining the facts at issue"; however, "to be binding, judicial admissions must be unequivocal." *See Airco Indus. Gases,*

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Inc. Div. of the BOC Group, Inc. v. Teamsters Health and Welfare Pension Fund, 850 F.2d 1028, 1036 (3rd Cir. 1988); *Glick v. White Motor Co.*, 458 F.2d 1287, 1291 (3rd Cir. 1972).

As evidence, plaintiffs first attempt to bind Cendant to representations in its August 1999 cross-claim against Ernst & Young ("E&Y"), to the effect that CUC's Chief Financial Officer Cosmo Corigliano and Senior Vice President/ Controller Anne Pember directed other CUC personnel to engage in four major categories of "accounting irregularities": inflation of pre-tax operating income ("topside adjustments"), inappropriate reversal of merger reserves, improper revenue recognition, and understatement of membership cancellation reserves. Yeager Br. at 34-35, quoting Cross-Claim ¶¶ 76-80. That pleading has since been superseded; the Yeager plaintiffs now rely on Cendant's amended cross-claim dated June 19, 2000, that:

- The illegal scheme to report nonexistent income to meet Wall Street's targets was an "ingrained part of the CUC corporate culture" (¶ 17);

- The fraud lasted at least 11 years, beginning in 1986 (¶ 13);

- "The participants in the illegal scheme included virtually the entire senior management of CUC, including but not limited to its former chairman and chief executive officer Walter Forbes, its former president Kirk Shelton, and two of its former chief financial officers, Stuart Bell and

his successor Cosmo Corigliano. Various middle-level managers at CUC also became involved in carrying out this scheme, including but not limited to Anne Pember, its former senior vice president and controller, and Casper Sabatino, its former vice president of accounting and financial reporting" (¶ 14), as did Chris McLeod, president of the Comp-U-Card division (¶ 19); and

¶ "The goal of [the] illegal scheme was to ensure that CUC always met Wall Street's growing earnings expectations for the company. Wall Street analysts regularly released expectations for CUC's earnings, as they do for many publicly-traded companies. CUC's senior management knew that meeting or exceeding these expectations was a key factor for the stock price of any publicly-traded company and therefore set out to ensure that the company met Wall Street's targets every year regardless of the company's actual earnings." (¶ 13).

Cendant's Amended Cross-Claim, Suppl. Kozberg Decl. Exh. 1. Plaintiffs rely on these representations, the binding effects of which are not disputed by Cendant, to show that "nearly the entire senior management of CUC acted with scienter when they intentionally and fraudulently overstated CUC's reported income in order to manipulate CUC's stock price." Yeager Reply Br. at 8.

Plaintiffs further rely on the Audit Report, to which Cendant repeatedly referred in response to plaintiffs' requests

for admissions during discovery. *See* Yeager Appendix Exh. 4. When asked whether the Audit Report accurately describes accounting irregularities at CUC for the years 1995, 1996 and 1997, Cendant responded:

> After a reasonable inquiry, Cendant believes the information known by or readily available to Cendant is insufficient to enable Cendant to admit or deny this Request. However, Cendant has no reason to believe that the Audit Report fails to accurately describe CUC's accounting irregularities during the relevant time periods discussed therein.

See Cendant's March 2000 Response to Plaintiffs' First Set of Requests for Admission, Yeager Appendix Exh. 4, ¶ 56. Consequently, the plaintiffs characterize the Audit Report as a judicial admission, the contents of which are "conclusively established" by effect of Federal Rule of Civil Procedure 36(b) and its adoption by Cendant's Audit Committee. *See also Airco*, 850 F.2d at 1035.

Specifically, plaintiffs seek to bind Cendant to its supposed statements in the Audit Report that "numerous accounting irregularities and improper accounting practices were *intentionally* committed in order to inflate revenues, understate expenses, and overstate CUC's (and Cendant's) operating income, income and earnings per share." (Emphasis added). Yeager Br. at 9, citing Statement of Undisputed Facts ¶ 28, citing Cendant's August 1998 Form 8-K, which contained the Audit Report as Exhibit 99.1, at 16, and Press Release, at 141-143. Further, plaintiffs charge, the Audit

Report identifies Corigliano and Pember as members of the "upper echelon" of CUC's management who directed the accounting fraud. Statement of Undisputed Facts ¶ 29, citing Audit Report at 46-140.

Cendant counters by attacking plaintiffs' ratiocination. The Yeager plaintiffs argue that, because certain high-ranking corporate officers of CUC have admitted knowledge of the fraud constituting scienter, such state of mind can be attributed to present defendant Cendant. Such contention relies upon two assumptions: first, that the knowledge of the CUC employees can be attributed to their corporate employer; and second, that any scienter of CUC can be imported to its successor corporation Cendant.[3]

Regarding the first premise, Cendant argues that as a "legally distinct" corporate entity, it should not be charged with knowledge possessed by its employees. Factually, Cendant claims that the Audit Report found no knowledge of the fraud by: "any officer responsible for Cendant's day-to-day operations after the CUC/HFS merger," any member of CUC's or Cendant's Board of Directors, nor, based on the information available, CUC's two most senior executive officers Forbes and Shelton. Cendant Br. at 12-13. Though Cendant admits that the Audit Report implicated Corigliano and Pember, the corporation charges that no findings have been made as to their motives. *Id.* at 13.

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3. Defendants apparently concede plaintiffs' charge that, because CUC was (simply) renamed Cendant after the HFS merger, there is no legal distinction of import here between CUC and Cendant. Reply Br. at 3 n.5.

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Cendant relies on a line of decisions which hold that "the knowledge and actions of employees acting adversely to the corporate employer cannot be imputed to the corporation." *Kaplan v. Utilicorp United, Inc.*, 9 F.3d 405, 407 (5th Cir. 1993) (discussing Section 10(b) standing); *see also Alpern v. Utilicorp United, Inc.*, 1994 WL 682861, at *3 (W.D. Mo. 1994) (in related case concerning same underlying fraud, rejecting plaintiff shareholder's argument that the knowledge of subsidiary's corporate officers could be imputed to parent corporation merely because they held high ranking positions in the company). As discussed by the *In re Jack Greenberg* court, 212 B.R. 76, 84 (E.D. Pa. Bankr. 1997):

> The rule that knowledge or notice on the part of the agent is to be treated as notice to the principal is founded on the duty of the agent to communicate all material information to his principal, and the presumption that he has done so. But the legal presumptions ought to be logical inferences from the natural and usual conduct of men under the circumstances. But no agent who is acting in his own antagonistic interest, or who is about to commit a fraud by which his principal will be affected, does in fact inform the latter, and any conclusion drawn from a presumption that he has done so is contrary to all experience of human nature.

(referencing *Gunster v. Scranton Illuminating, Heat & Power Co.*, 181 Pa. 327, 337-38 (1897)). Plaintiffs accurately note, however, that these cases, and others advanced by Cendant,

concerned misappropriation by corrupt officers of corporate funds for personal use — a situation clearly involving adverse interests. *See, e.g., In re Investors Funding Corp. of New York Securities Litig.*, 523 F. Supp. 533, 537, 540 (S.D.N.Y. 1980). *Also see F.D.I.C. v. Shrader & York*, 991 F.2d 216, 224-25 (5th Cir. 1993) (distinguishing between fraud committed by an officer against employer corporation, which is not imputed to the corporation, and fraud committed for the benefit of the corporation); *Cenco Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982) (Posner, J.) (same; analyzing "underlying objectives of tort liability").

Defendant further relies on *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 884 (3rd Cir. 1975) that, under general agency principles, "the fraud of an officer of a corporation is imputed to the corporation when the officer's fraudulent conduct was (1) in the course of his employment, and (2) for the benefit of the corporation. . . . The underlying reason is that a corporation can speak and act only through its agents and so must be accountable for any acts committed by one of its agents within his actual or apparent scope of authority and while transacting corporate business." *See also U.S. v. One Parcel of Land Located at 7326 Highway 45 North, Three Lakes, Oneida County, Wis.*, 965 F.2d 311, 316-17 (7th Cir. 1992) (in drug forfeiture action, discussing corporate agency principles, intra-court variations on that theme, and the adverse agent exception).

Cendant claims that, without deposition testimony or "other direct, concrete proof" of the motives of those who authorized and implemented the accounting irregularities, a ruling that the knowledge of former employees can be

imputed to the corporation would be premature. Cendant Br. at 15-16. The court agrees. At this early stage of litigation, the court is unable to answer even the preliminary question of exactly which CUC or Cendant employees were aware of the fraud. *See* Cendant Br. at 12 (asserting that Audit Report contains no finding that "any officer responsible for Cendant's day-to-day operations after the CUC/HFS merger" knew of the accounting irregularities before April 1998); *cf.* Yeager Reply Br. at 5 (alleging that Cendant has admitted the participation of CUC/Cendant directors Forbes, Shelton and McLeod, citing Cendant's Answer to Yeager Complaint ¶ 8); *cf.* Cendant Br. at 13 (claiming without citation that both Forbes and Shelton have denied knowledge of or participation in the fraud); *cf.* Yeager Reply Br. at 3-4 (citing Audit Report at 18 that Casper Sabatino, Vice President of Accounting and Financial Reporting, Kevin Kearney, Director of Financial Reporting and Controller of a CUC subsidiary, Steven Speaks, Controller of Comp-U-Card after June 1997, and Mary Sattler, Supervisor of Financial Reporting for CUC, have each admitted participation and direction in the fraud).

As for those individuals whose culpable participation is admitted, no record has yet been developed as to whether the fraud was conducted for their personal benefit or that of the corporation. The possibility of adverse interests between the guilty employees and the corporation remains open. The Western District of Pennsylvania denied summary judgment on similar facts, reasoning that although certain corporate employees had testified that "the motivation behind the fraud and resultant cover-up was to provide time for management to resolve [the corporation's] underlying business problems,

such a motivation does not . . . necessarily equate to a finding that the fraudulent actors intended to benefit" the corporation. *In re Phar-Mor, Inc. Securities Litig.*, 900 F. Supp. 784, 787 (W.D. Pa. 1995). "Indeed, a reasonable trier of fact could conclude that the true motive of the wrongdoers was the preservation of their employment, salaries, emoluments, and reputations, as well as their liberty, at the expense of [the corporation's] well-being." *Id.*; *see also In re Kidder Peabody Securities Litig.*, 10 F. Supp. 2d 398, 415-417 and n.17 (S.D.N.Y. 1998) (finding evidence to support a reasonable inference of corporation's scienter where a securities analyst had openly reported hundreds of millions of dollars in false profits, but not deciding imputation issue because of dispute as to whether trader was acting adversely to corporation's interests). And in that circumstance, the determination of *Rochez* that in securities fraud cases, respondeat superior is generally not available could prevail. *Rochez*, 527 F.2d at 886.

Plaintiffs do not benefit from *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 193 (3rd Cir. 1981) which affirmed corporate liability under Section 10(b) on a theory that accounting firms owe a stringent duty to supervise their employees, and where the jury responded affirmatively to the special interrogatory, "Do you find that [a corporate employee], *acting in the scope and course of his duties as an employee of defendant*, caused with scienter . . . the material misrepresentations [or] the material omissions?" (Emphasis added). That narrow interrogatory begs our issue — namely, whether the corporate officers here acted in the scope and course of their duties, and to the benefit of the corporation.

As in *Phar-Mor*, such material factual controversy can be resolved only by a trial fact finder. That said, it is also noted that the Private Securities Litigation Reform Act of 1995 requires the fact finder to ultimately determine the percentage of responsibility of each person putatively involved, "measured as the percentage of total fault of all persons who caused or contributed to the loss incurred by plaintiff," and "[w]hether such person knowingly committed a violation of the securities laws." 15 U.S.C. § 78u-4(f)(3)(A)(ii)-(iii). Plaintiffs' motion for summary judgment on their Section 10(b) and Rule 10b-5 claims is denied without prejudice.

5. *Section 14(a)*

Section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a), makes it unlawful for "any person . . . to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any [registered] security" in contravention of SEC rules. In turn, SEC Rule 14a-9 prohibits solicitation by means of a proxy statement "containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading." 17 C.F.R. § 240.14a-9.

Section 14(a) is analogous to Section 11: each "proscribes a type of disclosure or lack of it" and "involves single specific

documents which are of primary importance in two fundamental areas of securities regulation," and neither requires a showing of scienter. *Gould v. American-Hawaiian S.S. Co.*, 535 F.2d 761, 777-78 (3rd Cir. 1976). To prove entitlement to summary judgment, plaintiffs must show that: (1) a proxy statement contained a material misrepresentation or omission which (2) caused them injury and (3) the proxy solicitation itself, rather than the particular defect in the solicitation materials, was "an essential link in the accomplishment of the transaction." *General Elec. Co. by Levit v. Cathcart*, 980 F.2d 927, 932 (3rd Cir. 1992) (citations omitted). Again, "an omitted fact is material 'if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.' " *Id.*

Plaintiffs allege that the misstatements concerning CUC's financial status in the Joint Proxy/Prospectus were indisputably material. They further assert that the proxy solicitation was an "essential link" in the chain of events leading up to the merger because shareholder approval, secured by means of the Joint Proxy/Prospectus, was a condition precedent to the merger's consummation. Yeager Br. at 38. Again Cendant raises no contest.

This court accepts plaintiffs' unchallenged evidence and grants summary judgment on their Section 14(a) claims.

Appendix D

CONCLUSION

Summary judgment against (only) Cendant is granted in part and denied in part: Plaintiffs' motion for summary judgment of liability is granted as to their claims under Section 12(a)(2) of the Securities Act and Section 14(a) of the Exchange Act. The motion is denied without prejudice as to plaintiffs' Section 10(b) claims. Plaintiffs' motion for summary judgment on their Section 11 claims is granted as to liability; and because Cendant concedes $11,661,078.96 in Section 11 damages, partial summary judgment as to that amount of damages is also granted.

SO ORDERED:

s/ William H. Walls
William H. Walls, U.S.D.J.

8 August 2000
Dated

Appendix D

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Consol. Civ. Action No. 98-1664

IN RE CENDANT CORPORATION
SECURITIES LITIGATION

This document relates to:

WILLIAM P. YEAGER and VIRGINIA I. YEAGER,
Co-Trustees of the William P. Yeager
and Virginia I. Yeager Trust,

Plaintiffs,

v.

CENDANT CORPORATION, et al.,

Defendants.

ORDER

Walls, United States District Judge

Plaintiffs William P. and Virginia I. Yeager, co-trustees of the William P. Yeager and Virginia I. Yeager Trust (collectively "Yeager plaintiffs"), move for partial summary judgment on certain of their federal securities law claims against solely defendant Cendant. The court heard oral argument on July 31, 2000. For the reasons stated in the accompanying opinion,

Appendix D

It is this 8th day of August, 2000:

ORDERED that summary judgment against Cendant is granted in part and denied in part:

1) The Yeager plaintiffs' motion for summary judgment of liability on their claims under Section 12(a)(2) of the Securities Act and Section 14(a) of the Exchange Act is granted;

2) The motion is denied without prejudice as to plaintiffs' Section 10(b) claims;

3) Plaintiffs' motion for summary judgment on Section 11 claims is granted as to liability; and because Cendant concedes $11,661,078.96 in Section 11 damages, partial summary judgment as to that amount of damages is also granted.

s/ William H. Walls
William H. Walls, U.S.D.J.

APPENDIX E — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY DATED SEPTEMBER 4, 1998 AND FILED SEPTEMBER 8, 1998

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 98-1664

In re: Cendant Corporation Litigation

OPINION

Walls, District Judge

The 1995 Private Securities Litigation Reform Act ("PSLRA" or "Reform Act") was enacted by Congress to curb perceived abuses in the litigation process — widespread initiation and manipulation — of securities class-actions by "professional" plaintiffs and lawyers. Acknowledging the value of private securities litigation, *see Gluck v. Cellstar Corp.*, 976 F. Supp. 542, 544 (N.D. Tex. 1997), Congress also recognized that under the prior regime, "[c]ourts traditionally appoint[ed] lead plaintiff and lead counsel in class action lawsuits on a first come, first serve basis." S. Rep. No. 104-98 (1995) reprinted in U.S.C.C.A.N. 679. This encouraged a "race to the courthouse" among parties seeking lead-plaintiff status and spawned a cottage-industry of specialized securities litigation firms that "researched potential targets for these suits, enlisted plaintiffs, controlled the course of the litigation, and often negotiated settlements that resulted in huge profits for the law firms with only marginal recovery for the shareholders." *Gluck*, 976 F. Supp. at 544 (citing S. Rep. No. 104-98 at 687)

To stem this unhealthy trend, the Reform Act establishes a presumption that among the parties seeking to lead the class, the persons or group of persons with "the largest financial interest in the relief sought by the class" is the "most adequate plaintiff" to do so. 15 U.S.C. § 77z-1(a)(3)(B)(iii)(I)[1]. That plaintiff then selects counsel to represent the class. 15 U.S.C. § 77z-1(a)(3)(B)(v). The goal of this scheme is to "increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff's counsel." H.R. Rep. No. 104-369 at 32 (1995) reprinted in 1996 U.S.C.C.A.N. at 731. Its underlying assumption is that the plaintiff or plaintiff group with the strongest financial interest will pursue the claims with the greatest vigor and will have both the interest and the clout to engage qualified counsel at the best rates for the class. The court is then charged with ensuring that the reality of the case accords with these assumptions. Thus, the lead plaintiff presumption is rebuttable, 15 U.S.C. § 77z-1(a)(3)(B)(iii)(I), and that party's selection of counsel subject to court approval. 15 U.S.C. § 77z-1(a)(3)(B)(v).

This matter comes before the Court by the motions of fifteen plaintiffs or plaintiff groups for appointment as lead plaintiff in this shareholder class action. Each movant also seeks to have its chosen attorneys selected as lead counsel, and some motions were made for appointment of liaison

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1. For the sake of brevity, this opinion shall refer to the relevant Reform Act amendments to the Securities Act of 1933. The corresponding amendments to the Securities Exchange Act of 1934 are found at 15 U.S.C. § 78u-4.

counsel. The Court heard oral argument on this matter on August 4, 1998.[2] For the reasons that follow, the Court designates Welch & Forbes as lead plaintiff for the claims filed on behalf of the holders of "Feline Prides" derivative products, and the Public Pension Fund Investors as lead plaintiffs for the claims of all other shareholders. Lead counsel shall be determined through a process of competitive bidding, after which each lead plaintiff's present counsel, if a participant in the bidding and otherwise qualified, shall be afforded the opportunity to meet the lowest bids on their respective claims. The motion for appointment of liaison counsel is denied.

Background

Defendant Cendant Corporation is one of the world's largest providers of consumer and business services. Among other things, the company provides access shopping, automobile and dining services, mortgage services and real estate brokerage services. Cendant was formed on or about December 18, 1997 when its predecessor, CUC International, Inc. ("CUC") merged with HFS, Inc. Under the terms of the merger, all outstanding shares of HFS common stock were exchanged for CUC shares and the merged entity took the name "Cendant."

On April 15, 1998, after the stock market closed, Cendant announced that it had uncovered substantial accounting irregularities in a former CUC business unit — now part of

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2. On August 24, 1998, the Court entertained additional argument and modified its initial holding on the basis of the new evidence presented. *See infra*, fn. 5.

the merged entity. As a result of this revelation, the company announced that it would have to restate its reported annual and quarterly net income and earnings per share for 1997 and possibly for earlier periods as well. The market reacted to the news with predictable disfavor. On the day after the announcement, Cendant's stock price plummeted 46 percent. In the ensuing days, a flurry of shareholder suits were filed in this and other districts against Cendant, its directors, and various other relevant parties. To date, there are upwards of 64 such actions. With the exception of the single shareholder derivative action, the cases either have been or are in the process of being consolidated.

Plaintiffs in the various actions fall into one or more of four categories: (1) former holders of CUC shares; (2) former holders of HFS stock; (3) purchasers of Cendant stock; and (4) holders of Feline Prides ("Prides") — a derivative security based on Cendant common stock. All of the actions sound in fraud. The Prides-holders, who purchased the security pursuant to a registration statement and prospectus, allege violations of Sections 11, 12(a)(2), 15 and 22 of the Securities Act of 1933 (the "Securities Act" or " '33 Act"). Shareholders of Cendant common stock, having acquired their holdings both on the open market as well as pursuant to the Joint Proxy Statement/Prospectus of CUC and HFS, charge defendants with violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act" or " '34 Act") and violations of Sections 11, 12, 15 and 22 of the '33 Act. Fifteen plaintiffs or groups of plaintiffs filed motions for appointment as lead plaintiff. Each movant also sought to have its attorney or attorneys selected as lead counsel for the class.

Appendix E

Discussion

I. *Selection of Lead Plaintiff*

The PSLRA instructs the Court to "appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of the class members." 15 U.S.C. § 77z-1(a)(3)(B)(i). To this end, the statute sets forth

> a presumption that the most adequate plaintiff in an private action arising under this subchapter is the person or group of persons that —
>
> (aa) has either filed the complaint or made a motion in response to a notice under subparagraph (A)(i);[3]
>
> (bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and
>
> (cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

15 U.S.C. § 77z-1(a)(3)(B)(iii)(I). It further provides that

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3. Under the statute, plaintiffs must publicize the pendency of the action within 20 days of the filing of the complaint. 15 U.S.C.A. § 77z-1(a)(3)(A)(i). Within 60 days of such publication, any member of the purported class may then petition the court to serve as lead plaintiffs. *Id.*

> [t]he presumption described in subclause (I) may be rebutted only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff —
>
> (aa) will not fairly and adequately protect the interests of the class; or
>
> (bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class.

15 U.S.C. § 77z-1(a)(3)(B)(iii)(II).

At the outset, none of the movants knew the extent of any of the other plaintiff's or group of plaintiffs' financial interest in the litigation. Consequently, each applicant's moving brief consisted primarily of a statement that it had complied with the procedural requirements of the statute and an assertion that that plaintiff or amalgamation of plaintiffs was most adequate to lead because of the losses it had incurred. While most of the applicants quantified their losses, some simply relied on the assertion that they were most qualified. One movant's claims clearly stood out.

The "Public Pension Fund Investors," or "CalPERS group," formed from the California Public Employees' Retirement System ("CalPERS"), the New York State Common Retirement Fund ("CRF") and the New York City Pension Funds ("NYCPF") alleged combined losses in excess of $89 million. This dwarfed the next largest claim of $10.6 million asserted by the State Teachers Retirement System of

Ohio, the City of Philadelphia and various individual plaintiffs ("The Ohio/Philadelphia Group"). Because the Public Pension Fund Investors had invested in each of the four types of securities at issue, the other movants could not rightly challenge the typicality of its claims. *See Gluck*, 976 F. Supp. at 546 (applicant for lead plaintiff status need only make a preliminary showing that it satisfies the requirements of Rule 23). Competing movants responded to the CalPERS group's motion either by seeking appointment as co-lead plaintiff on the ground that the Public Pension Fund Investors could not adequately represent the entire class alone, or by attempting to rebut the statutory presumption that the CalPERS group was most adequate to lead.

a. Propriety of Appointing Co-Lead Plaintiff(s)

Notwithstanding the diversity of the CalPERS group's holdings, nine movants petitioned the Court for appointment as co-lead plaintiff. While some offered little more than the general assertion that diversity of representation would benefit the class, others endeavored to challenge the typicality and adequacy of the CalPERS group's claims. None, it should be noted, purported to rebut directly the presumption that the Public Pension Fund Investors were the most adequate lead plaintiffs. Instead, each attempted to distinguish its interests from those of the CalPERS group in an effort to justify broader representation among the lead plaintiffs.

One movant, for example, asserted that it should have a voice because it had suffered the largest losses of any *private* investor and argued that it would have a stronger incentive than the CalPERS group to pursue this action zealously

because its losses were greater in proportion to its total assets. Others maintained that *individual* investors should be represented among the lead plaintiffs because large institutions might be unduly concerned with potential disruption of valuable business relations with certain defendants. Still another group asserted that options-holders should be explicitly represented because their interests might, at some point in the litigation, diverge from those of the other shareholders.

Several movants charged that the Public Pension Fund Investors were ill suited to pursue claims based on Prides as well as the claims of common stockholders. Some warned that the CalPERS group, having incurred a substantial proportion of its losses as a result of its open-market purchases, would be motivated to "tilt" the litigation in favor of recovery on the '34 Act claims. Others maintained that the CalPERS group — and other public pension fund plaintiffs — by virtue of their size and investment activity, had developed "special relationships" with underwriters that would create a disincentive to pursue certain avenues of recovery available only to Prides-holders. Finally, some movants asserted that additional lead plaintiffs were warranted in this case because additional attorneys would be better able to advance the potentially high costs and expenses of litigating this action. While all of these arguments raised valid concerns, none was persuasive.

More likely than not, the putative class in any large shareholder action will be composed of plaintiffs whose portfolios differ in composition from one another. This, however, does not justify the appointment of potentially innumerable co-lead plaintiffs to ensure that each

individualized interest is represented. Competing movants may be correct that the resolution of this case could ultimately favor holders of one type of security over the others. On the other hand, representation by a disparate group of plaintiffs, each seeking only the protection of its own interests, could well hamper the force and focus of the litigation. A balance must be struck.

The Reform Act demands only that the interests of the class members be *adequately* represented by the lead plaintiff. 15 U.S.C. § 77z-1(a)(3)(B)(i). Thus, notwithstanding every plaintiff's undeniable interest in an outcome most favorable to his or her position, every warrior in this battle cannot be a general. Absent a showing sufficient to rebut the CalPERS group's presumption of adequacy, what matters here is that the claims of every member or constituent group of the putative class arise from the same false or allegedly fraudulent representations of CUC. The Public Pension Fund Investors have significant holdings in each type of security held by the putative plaintiff class and have suffered enormous losses. It is unrealistic to assume that they would not travel every avenue that could potentially enhance their potential recovery. And in pursuit of their interests, the Public Pension Fund Investors will necessarily seek to establish the elements of every plaintiff's claim. Under these circumstances, such self-interest of the presumptive lead plaintiffs will ensure adequacy of representation for all the class.[4] *See also Gluck*, 976 F. Supp. at 547-48 (dismissing speculative challenges to adequacy and typicality for similar reasons.) Moreover,

4. This determination is, of course, made without prejudice to plaintiffs' ability to later move for the creation of appropriate sub-classes pursuant to Fed. R. Civ. P. 23(c)(4)(B).

"separate proceedings can, if necessary, be held on individualized issues. . . . Rule 23(a) does not require that class members share every factual and legal predicate to meet the commonality and typicality standards." *In re General Motors Corp. Pick-Up Truck Fuel Tank Prod. Liability Litig.*, 55 F.3d 768, 817 (3d Cir. 1995) (hereinafter "*General Motors*"); *see also In re Prudential Ins. Co. America Sales Practices Litig. Agent Actions*, __ F.3d __, 1998 WL 509156, at *20 (3d Cir. July 23, 1998).

Finally, the argument that additional plaintiffs bring to the litigation other counsel capable of advancing additional funds is based upon the mistaken assumption that lead plaintiff comes inextricably tied to its counsel. As will be discussed, this is not necessarily so. A particular law firm's ability to sustain the action goes to its qualifications as lead counsel; it has no bearing on which or how many of the plaintiffs shall lead the charge. Accordingly, all motions for appointment as co-lead plaintiff that do not challenge the Public Pension Fund Investors' statutory presumption of adequacy are denied.

b. Attempts to Rebut the Presumption

i. *Counsel considerations*

Plaintiffs Joanne A. Aboff Family Trust and Douglas Wilson ("Aboff and Wilson") challenged the adequacy of the CalPERS group because of its selection of counsel. Aboff and Wilson first argued that they were better suited to lead than the CalPERS group because they had negotiated a reduced fee schedule with their attorneys. They asserted that their lower counsel costs rebutted the statutory presumption in

favor of the Public Pension Fund Investors since it would result in a greater percentage of any recovery accruing to the class.

Aboff and Wilson further argued that scrutiny of counsel arrangements was particularly important here because considerations other than the interests of the class might have influenced the CalPERS group when it retained its attorneys. Specifically, these plaintiffs charged that counsel for the CalPERS group had made substantial contributions to the campaign of the New York State Comptroller, who, as sole trustee of the CRF, has substantial influence over the decisions of the fund. This, they argued, created an appearance of impropriety because the contributions may have played a role in the selection of the group's counsel — a practice known as "pay-to-play." Finally, if their reduced fee arrangement was not sufficient to rebut the presumption and justify their appointment as lead plaintiffs, Aboff and Wilson urged that the Court should select lead plaintiff through a process of competitive bidding.

While all of these arguments were interesting, none was grounded in the statutory language. The Reform Act is clear that the lead plaintiff presumption can be rebutted "*only* upon proof . . . that the presumptively most adequate plaintiff . . . will not fairly and adequately protect the interests of the class; or is subject to unique defenses that render such plaintiff incapable of adequately representing the class." 15 U.S.C. §§ 77z-1(a)(3)(B)(iii)(II)(aa), (bb) (emphasis added). Aboff and Wilson's speculative assertions provided neither.

First, the Court notes that favorable attorneys' fees are but one of a number of important class interests that must be pursued by lead plaintiffs. Indeed, one of the assumptions

underlying the Reform Act's presumption of adequacy is that plaintiffs with the assets necessary to have made large investments will also be able to negotiate the most advantageous counsel rates to the class. Yet the rationale for the statutory presumption extends further.

Simply put, the party with the largest financial interest in the litigation has the most to gain from any marginal increase in dollars recovered per share. In this case, it is not lost on the Court that Aboff and Wilson did not, until pressed by the Court, reveal that they had sustained losses of only about $100,000. The reason is clear. In terms of sheer dollar amounts, any recovery, good or bad, will be felt almost 900 times as strongly by the CalPERS group as it will by Aboff and Wilson. Who has the greater incentive to pursue the most favorable end to this action?

Speculative allegations of pay-to-play were similarly unimpressive. Questioned at oral argument, Aboff & Wilson admitted that the campaign contributions against which they railed were violative of no New York law or any other law. Asked if they could present any proof of wrongdoing by the CalPERS group or its attorneys, Aboff and Wilson admitted that they could not. Thus, given the opportunity to "put up or shut up," where the statute clearly requires the former, Aboff and Wilson chose the latter. Their argument is dismissed.

Finally, while the Court was attentive to the suggestion that lead plaintiff be selected through a process of competitive bidding based on attorneys fees, it notes that the PSLRA permits no such thing. Because Congress has now decreed that certain facets of the litigation be given paramount consideration, that tail can no longer wag this dog.

ii. *Conflicts of Interest*

In the end, only one movant was successful — partially — in rebutting the statutory presumption of adequacy. Plaintiff Welch & Forbes, present in this case because of substantial Prides-related losses, claimed that Merrill Lynch, as underwriter of the Prides offering, would be a necessary defendant in any action on behalf of Prides holders. It further charged that the Public Pension Fund Investors hold combined investments in Merrill Lynch in excess of $300,000,000 — a figure several times greater than the $6,400,000 they allege to have lost in their Prides — and could not be expected to pursue vigorously recovery from that defendant.

Offered the opportunity at oral argument, the attorneys for the CalPERS group did not deny this overwhelming financial interest in a potential defendant. Though they publicly (and theatrically) pledged to the Court and gallery to pursue any and all viable claims against Merrill Lynch, logic and simple mathematics speak louder. The Court simply does not believe nor find that the CalPERS group can overcome this substantial conflict of interest and fully protect the interests of the Prides-holders. Because of this infirmity, the Court appoints the CalPERS group as lead plaintiffs for all matters save those involving Prides securities. Welch & Forbes, the non-conflicted party[5] with the next largest

5. At the initial hearing, the Court selected the group led by the State of Connecticut Retirement Plans and Trust Funds to lead the Prides claims because after the CalPERS group, it had suffered the next largest losses based on Prides. At the August 24th reargument, that plaintiff was removed as lead plaintiff when the Court was made aware that Connecticut, too, had holdings in Merrill Lynch far in excess of its Prides losses.

holdings of Prides is appointed colead plaintiff to pursue all claims based on that security. This selection of lead plaintiffs is made without prejudice to any party who seeks to contest such designation at the time of the motion for class certification.

II. *Selection of Lead Counsel*

The Reform Act instructs that "[t]he most adequate lead plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class." 15 U.S.C. § 77z-1(a)(3)(B)(v). In contrast to the strictly defined procedures and considerations that prescribe the determination of lead plaintiff, here the Court's approval is subject to its discretionary judgment that lead plaintiff's choice of representative best suits the needs of the class.[6]

It is reasonable to assume that given the opportunity, absent class members would try to secure the most qualified representation at the lowest cost. As one court has noted, "the ultimate goal in class action litigation — that is, for the members of the plaintiff class — is to maximize the benefit to the class members if the litigation proves successful (either by way of settlement or through trial), and there can be no doubt that the class is best served by obtaining highly qualified class counsel who are prepared to undertake the representation on a basis that will maximize that recovery (something that necessarily implicates what counsel will charge for their services)." *Raftery v. Mercury Finance Co.*, 1997 WL 529553 (N.D. Ill. Aug. 15, 1997).

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6. In common fund class actions, the Court takes on fiduciary duties to the class. *See Oracle*, 131 F.R.D. at 691.

The PSLRA attempts to protect the class by instructing that "[t]otal attorneys' fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class." 15 U.S.C. § 77z-1(a)(6).[7] But as the *Raftery* court rightly wrote, reliance on this provision presupposes "that the court will be able to divine the reasonable value of the services rendered when the time comes, a false presupposition." 1997 WL 529553 at *2. It is no insult to the judiciary to admit that a court's expertise is rarely at its most formidable in the evaluation of counsel fees; judges rarely retain counsel. And even though a lead plaintiff presumed to have identity of interests with the rest of the class might also be presumed to be motivated by appropriate price and quality considerations, the statutory requirement that lead plaintiff's selection is subject to court approval, indicates that the Court should not rely solely on that party's judgment. There are other mechanisms to aid the Court.

There is an emerging trend in common fund class actions for courts to simulate the free market in the selection of class counsel. The use of an auction to select counsel in a securities class action was pioneered by District Judge Vaughn Walker's insightful and innovative opinions which directed the *In re Oracle Securities Litigation*, 131 F.R.D. 688 (N.D. Ca. 1990), 132 F.R.D. 538 (1990) and 136 F.R.D. 639 (1991). Those decisions, and those that followed Judge Walker's lead, sought to provide a framework for reasonable counsel fees and costs which are to be borne by all plaintiffs in the event

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7. *See also* Fed. R. Civ. P. 23(e) ("A class action shall not be dismissed or compromised without the approval of the court . . .").

of recovery. *See Oracle*, 131 F.R.D. at 692 ("the problem facing the court is how to approximate what the class members would do if they were involved in the decision-making"); *In re Amino Acid Lysine Antitrust Litig.*, 918 F. Supp. 1190, 1194 (N.D. Ill. 1996) ("The object . . . is to give the lawyer what he would have gotten in the way of a fee in an arm's length negotiation, had one been feasible. . . . [T]o simulate the market where a direct market determination is infeasible."); *Raftery*, 1997 WL 529553. These courts have recognized that the most effective way to establish reasonable attorney fees is through marketplace (which this Court terms, adversarial) competition. This Court shares their resolve. Its rationale is simple and flows from the tradition of the profession.

The task of lead counsel carries substantial responsibility. Lead counsel must represent not only the interests of a lead plaintiff, but all members of the putative class. It follows then that such responsibility should be borne by counsel of the highest professional talent, accompanied by a similarly high degree of integrity. Such talents have been developed and manifested in this type of litigation. Such qualities, per force have been hewn by the adversarial foundation of our trial system. To seek the requisite reasonableness of costs for such talent which are to be borne by the entire plaintiff group in the event of recovery, it is the Court's judgment that legal fees also be the subject of adversarial competition.

The Court shall conduct an auction to determine the lowest qualified bidder to represent the class as counsel. Any attorney or attorneys interested in serving as counsel to either of the two lead plaintiffs shall submit a sealed bid to the Court not later than 4:00 p.m., September 17, 1998 E.D.T.:

Appendix E

1. Each bidder shall submit his, her, or their professional qualifications to be lead counsel. Among anything else deemed relevant, this shall include a history of involvement in similar litigation, case titles, docket numbers, relevant dates, courts involved, the result, whether by trial or appeal, settlement or resolution and the time during litigation when such resolution or settlement occurred.

2. Bidders shall indicate their ability to undertake and maintain all costs of this litigation, and should express their readiness to post a performance bond and its amount, if required by the Court.

3. Bidders shall indicate how costs are to be deducted in the event of resolution favorable to the plaintiffs.

4. Applicants shall state their percentage fee bids according to one or both of the following "litigation milepost" grids:[8]

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8. Applicants may, of course, bid on both available positions. However, for obvious reasons, if one firm emerges as lowest qualified bidder for both lead plaintiffs, it shall be forced to choose. The remaining position shall go to the firm submitting the next lowest qualified bid.

Appendix E

In re: Cendant: Application for Lead Counsel

Fee Bid Schedule (Excluding Prides Claims)

Fees as Percentage (%) of Total Class Recovery

RECOVERY - INCREMENTS IN DOLLARS	PHASE AT WHICH LITIGATION IS RESOLVED			
	During pleadings through adjudication of any motion to dismiss	During discovery through adjudication of SJ motion	After adjudication of SJ motion through trial verdict	Post-trial
First 100 million				
Second 100 million				
Third 100 million				
Next 50 million				
Next 50 million				
Next 50 million				
Next 50 million				
Over 500 million				

In re: Cendant: Application for Lead Counsel

Fee Bid Schedule (Prides Claims)

Fees as Percentage (%) of Total Class Recovery

RECOVERY - INCREMENTS IN DOLLARS	PHASE AT WHICH LITIGATION IS RESOLVED			
	During pleadings through adjudication of any motion to dismiss	During discovery through adjudication of SJ motion	After adjudication of SJ motion through trial verdict	Post-trial
First 40 million				
Next 40 million				
Next 40 million				
Next 40 million				
Next 40 million				
Next 40 million				
Over 240 million				

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5. Each bidder shall certify that its bid is made in good faith and has been formulated, determined, prepared and forwarded to the Court without any assistance, revelation or collusion, direct or indirect, with any other party or competing law firm before submission to the Court.

6. Payment of the fees and costs of any lawyers or firms assisting the lead counsel, if any, will be the responsibility of lead counsel.

7. The Court reserves the right to reject any and all bids it deems not to have been made in good faith or which are contrary to the interests of the consolidated plaintiffs. In its discretion, the Court may solicit additional bids from any source.

Recognizing that the Reform Act affords an opportunity to lead plaintiffs to choose counsel subject to the approval of the Court, the Court maintains the same in the auction process. Upon determination of the lowest qualified bidder by the Court, if present counsel to a designated lead plaintiff is the lowest qualified bidder, that person or entity will be appointed by the Court. If not, that person or entity, if otherwise qualified, will have the opportunity to agree to the terms of what the Court has found to be the lowest qualified bid. If that person or entity accepts those terms, lead counsel status will be conferred upon it by the Court. If counsel does not exercise this right of first refusal, the lowest qualified bidder will serve the plaintiffs.

Appendix E

As mentioned, the Court acknowledges lead plaintiffs' statutory opportunity. However, whether under the present statute or earlier discipline, the Court is the final arbiter of fees sought by successful plaintiffs' lawyers in this action. *See* F.R.Civ.P. 23(e); 15 U.S.C. § 77z-1(a)(6). The mechanism of an auction gives to the Court a measure of needed foresight to meet its obligations to members of the group. The Court need not be compelled to learn by hindsight — to be told at the end of months or years of litigation, "this is what we seek for services *rendered.*"

The Court is required to protect the interests of all members of the class. If Congress had intended otherwise with its PSLRA, it could have easily permitted lead plaintiff to designate and retain counsel without judicial approval. It did not.

The auction will not obviate the Court's final review of fees and costs pursuant to Rule 23(e), *see e.g. In re General Motors*, 55 F.3d at 819 ("a thorough judicial review of fee applications is required in all class action settlements"), and/or 15 U.S.C. § 77z-1(a)(6) if this matter is ultimately resolved in favor of the putative class. During the requisite post-resolution evaluation, the results of the auction will serve as a benchmark of reasonableness.

This is not an invitation for cheapness of costs resulting from cheapness of quality. The Court is confident that professional skills of high order will be forthcoming by this procedure. Additionally, notwithstanding the absence of proof of pay-to-play, the auction is salutary because it removes any speculative doubt about that issue.

Appendix E

III. ***Necessity for Liaison Counsel***

The chief applicant for appointment as liaison counsel asserted that he would play an integral role in this action, advising lead counsel on local procedural matters, coordinating administrative matters, distributing communications between the Court and other counsel, convening meetings of counsel and advising parties of developments in the case. Qualified lead counsel will be surely capable of performing these ministerial tasks. The Court finds no need to involve another law firm in this matter. Accordingly, all motions for appointment of liaison counsel are denied.

s/ William H. Walls
William H. Walls, U.S.D.J.

Appendix E

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 98-1664

In re: Cendant Corporation Litigation

ORDER

Walls, District Judge

This matter having come before the Court upon the motions of several plaintiffs

1. for appointment as lead plaintiff;

2. for appointment of lead counsel; and

3. for appointment of liaison counsel,

AND

The Court having considered the arguments of the parties,

IT IS ON THIS 4th DAY OF SEPTEMBER, 1998,

ORDERED

That the motions of the Welch & Forbes and the CalPERS group are granted in that:

Appendix E

1. Welch & Forbes is appointed lead plaintiff for all claims based on Prides, and

2. The CalPERS Group is appointed lead plaintiff for all other claims in this action;

AND

Lead Counsel shall be selected through a process of competitive bidding;

AND

All motions for appointment of liaison counsel are denied.

s/ William H. Walls
William H. Walls, U.S.D.J.

APPENDIX F — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT DENYING PETITION FOR REHEARING DATED OCTOBER 4, 2001

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 00-2734

IN RE: CENDANT CORPORATION LITIGATION
ANN MARK, *Appellant in No. 00-2734*

Present: BECKER, *Chief Judge*, SLOVITER, MANSMANN, SCIRICA, NYGAARD, AMBRO, and FUENTES, *Circuit Judges*.

SUR PETITION FOR PANEL REHEARING WITH SUGGESTION FOR REHEARING *EN BANC*

The petition for rehearing filed by Appellant Ann Mark having been submitted to the judges who participated in the decision of this Court, and to all the other available circuit judges in active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court *en banc*, the petition for rehearing is DENIED.

BY THE COURT:

s/ [illegible]
Chief Judge

DATED: OCT 04 2001

Supreme Court, U.S.
FILED
FEB 7 2002
CLERK

No. 01-997

IN THE

Supreme Court of the United States

ANN MARK,

Petitioner,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, NEW YORK STATE RETIREMENT FUND and NEW YORK CITY PENSION FUNDS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF RESPONDENT CENDANT CORPORATION

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STATEMENT PURSUANT TO RULE 29.6

Respondent Cendant Corporation has no corporate parent and no publicly-held company owns ten percent or more of its stock.

Respondent Cendant Corporation ("Cendant") respectfully submits this brief in response to the Petition for a Writ of Certiorari by petitioner Ann Mark ("Mark").

STATEMENT OF THE CASE

In the interests of brevity, Cendant limits its Statement of the Case only to those facts that bear directly to the subject matter of this brief.

As Mark notes in her Petition for a Writ of Certiorari (the "Petition"), several parties who sought appointment as lead plaintiff in this action asserted that the three plaintiffs who were ultimately appointed by the district court to represent the putative class "would be motivated to 'tilt' the litigations in favor of recovery" on claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) ("Section 10(b) claims"), at the expense of claims under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k ("Section 11 claims"). Petition at 6 (citing Pet. App. 271a). Mark, however, was not one of the parties who raised this argument before the district court.

Additionally, Mark did not challenge the district court's order certifying the class in this action – which did not create sub-classes – at the time that order was entered.

When the parties to this action reached a settlement, however, Mark objected to the plan of allocation of the settlement proceeds among the members of the previously certified class. She argued that the plan of allocation, which was prepared exclusively by the lead plaintiffs, did not fairly apportion the settlement proceeds between those class members who possessed Section 11 claims and those who possessed only Section 10(b) claims, and requested that she be appointed lead plaintiff on behalf of a sub-class of persons with Section 11 claims for purposes of negotiating a new plan of allocation. Mark did not object to the terms of the settlement itself.

The district court overruled Mark's objections to the plan of allocation, and Mark appealed, again challenging only the plan of allocation and seeking appointment as lead plaintiff on behalf of a sub-class of persons with Section 11 claims for purposes of negotiating a new plan of allocation. The court of appeals affirmed the district court's rulings as they related to Mark's objection, and Mark then filed her Petition in this Court.

ARGUMENT

Cendant takes no position on whether this Court should grant Mark's Petition to review any questions properly brought before the Court by Mark.

However, since Mark's Petition contains arguments that could be perceived to challenge the district court's certification of the class in this action in the first instance (an issue on which Mark took no position at the time it was decided) and the overall adequacy of the settlement Cendant reached with the representatives of that class (to which Mark never objected), Cendant submits this response to clarify the issues that would properly be before the Court if the Petition were granted. *See* Sup. Ct. R. 15.2.

Although "[a] litigant seeking review in this Court . . . possesses the ability to frame the question to be decided in any way [s]he chooses," she is limited to raising only those questions "properly raised in the lower courts." *Yee v. City of Escondido*, 503 U.S. 519, 535 (1992). Here, as described above, the only issues "properly raised in the lower courts" by Mark were those relating solely to the plan of allocation, not to the terms of the settlement of this action or to the district court's original decisions certifying the class or appointing the class representatives with which Cendant negotiated the settlement. Accordingly, the only questions

that Mark can properly place before this Court are those relating to the plan of allocation, and not any additional questions that would require the Court to consider the issues of class certification, the appointment of the lead plaintiffs or the fairness, adequacy or validity of the settlement itself.

CONCLUSION

For the foregoing reasons, Cendant respectfully requests that, if the Court grants Mark's Petition, it limit its review to Mark's specific objections to the plan of allocation.

Respectfully submitted,

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Supreme Court, U.S.
FILED
FEB 7 2002
CLERK

(3)

No. 01-997

IN THE

Supreme Court of the United States

ANN MARK,

Petitioner,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, NEW YORK STATE COMMON RETIREMENT FUND AND NEW YORK CITY PENSION FUNDS,

Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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COUNTER-STATEMENT OF QUESTION PRESENTED

In a securities fraud class action asserting claims under § 11 of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934, based on the factual record of this case, did the district court abuse its descretion in approving the Lead Plaintiff's proposed plan of allocation for distribution of settlement proceeds that provides for each member of the Class to receive his or her *pro rata* share of the net settlement proceeds, and ensures that Class members with both §§ 11 and 10(b) claims are afforded the greater of the damages under the two provisions?

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RESPONDENTS' BRIEF IN OPPOSITION

Pursuant to United States Supreme Court Rule 15, respondents, California Public Employees' Retirement System, New York State Common Retirement Fund and New York City Pension Funds, submit this brief in opposition to the petition for a writ of certiorari.

COUNTER-STATEMENT OF THE CASE

This case presents the highly fact intensive and case-specific issue of whether the district court abused its discretion in approving a particular plan of allocation for distribution of settlement proceeds in the securities fraud class action brought on behalf of purchasers of publicly traded securities of Cendant Corporation ("Cendant") and its predecessor, CUC International, Inc. ("CUC"), *In re Cendant Corp. Litigation*, No. 98-CV-1664 (D.N.J.) (*"Cendant"*). The plan was approved by the district court and affirmed by the court of appeals along with the underlying settlements that achieved a recovery of more than $3.18 billion for the *Cendant* Class.

Petitioner contends that the plan was unreasonable because it failed to provide an enhanced recovery for certain Class members with claims arising under both § 11 of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934 compared with Class members with claims arising only under § 10(b).

In an effort to buttress petitioner's position, she further posits that an irreconcilable "conflict" arose within the certified Class after the settlements were achieved that required a separate counsel – not coincidentally, petitioner's counsel – to be appointed to represent the interests of Class members with § 11 claims, in order to "negotiate" a plan of allocation that provided such Class members with an enhanced recovery. However, as petitioner conceded below, that was not an essential element of her objection to the plan of allocation, clearly stating that even if a separate

plaintiff with separate counsel had been appointed, the plan of allocation "would still be objectionable."

The petition does not present any issue worthy of review by this Court. It does not challenge the approval of the settlements below, which petitioner acknowledges is "the largest settlement of a securities class action in history." Petition at 2. Rather, the petition challenges only the allocation plan for distribution of the settlement proceeds in this case, and does so on grounds that are completely dependent on the specific facts of this case. Moreover, the rulings of the courts below do not conflict with any decision of this Court, and there is no split among the circuit courts to be resolved. The petition raises no question of statutory interpretation that would even be relevant to other securities class actions.

The petition presents no issues suitable for this Court's review. It is an after-the-fact attempt to exploit the extensive work of Class counsel, which resulted in a record recovery for the *Cendant* Class, and to seize a disproportionate share of the settlement proceeds for a select group of Class members. The district court and Third Circuit correctly rejected this gambit.

A. Background of the Action

Cendant was formed through the merger of CUC International, Inc. ("CUC") and HFS Incorporated ("HFS") on December 17, 1997, pursuant to which holders of HFS common stock acquired 2.4031 shares of newly issued CUC common stock in exchange for each share of HFS stock (the "Merger"). CUC remained as the surviving company following the Merger and its name was changed to Cendant. Pet. App. 154a.

The action arises from a series of materially false and misleading public statements made first by CUC and then by Cendant during the period from May 31, 1995 through August 28, 1998 (the "Class Period"), which reported fraudulently inflated quarterly and annual financial results.

On April 15, 1998, Cendant first announced that it would restate its previously reported financial results for 1997 by approximately $0.11 to $0.13 per share because of accounting irregularities related to business segments of CUC. Pet. App. 154a. Cendant also stated that the Company's Audit Committee had retained an outside law firm as special legal counsel to investigate the accounting irregularities, assisted by an independent accounting firm.

On July 14, 1998, Cendant announced that it would restate CUC's annual and quarterly financial statements not just for 1997, as previously disclosed, but for 1995 and 1996; that the amount by which the 1997 financial statements had been overstated was more than double the original estimate revealed on April 15; and that a widespread and systemic fraud had occurred at CUC. Pet. App. 155a. On August 28, 1998, the Company filed with the SEC a 260-page report prepared by the independent law firm and public accounting firm, which further detailed the pervasive fraud that had corrupted 17 of CUC's 22 operating units, and had caused CUC's operating income to be inflated by approximately $500 million during the Class Period. *Id.* The report found that CUC's and Cendant's fraudulent accounting practices were carefully planned to ensure that CUC met or exceeded analysts' expectations.

The April 15, July 14 and August 28, 1998 announcements caused the market prices of Cendant's common stock to decline by 47%, 9% and 11%, respectively. Pet. App. 11a-12a. Over 60 securities fraud class action lawsuits were filed as a result of the disclosures. Pet. App. 12a.

B. Appointment of Lead Plaintiff

By Order entered June 1, 1998, the district court consolidated all class cases in one consolidated action (the "Action"). Numerous motions were made for appointment as lead plaintiff pursuant to the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4. There were applications for separate representation of different claims, different securities and different portions of the

Class Period. In accordance with the PSLRA, the district court found that the CalPERS Group (respondents herein), which suffered a collective loss in excess of $89 million, had the largest financial interest in the relief sought by the Class and appointed them, as a group, as Lead Plaintiff for all purchasers or acquirers of CUC and Cendant publicly traded securities other than PRIDES. Pet. App. 264a – 286a.[1]

C. The Pleadings

Lead Plaintiff/respondents filed an Amended and Consolidated Class Action Complaint (the "Complaint") on December 14, 1998. The Complaint alleged violations of §§ 11 and 15 of the Securities Act of 1933 (the "Securities Act") and §§ 10(b), 14(a), 20(a) and 20A of the Securities Exchange Act of 1934 (the "Exchange Act"), and sought certification of a single Class consisting of persons and entities who purchased or acquired publicly traded securities of Cendant and CUC except Cendant PRIDES from May 31, 1995 through August 28, 1998 (the "Class Period"), with the exception of defendants and certain affiliated persons. Defendants were Cendant; certain former directors and officers of CUC and HFS, and CUC's outside accounting firm, Ernst & Young LLP ("E&Y"). Pet. App. 155a – 158a. Petitioner Mark affirmatively joined in the Complaint, claiming damages from purchases of Cendant stock both in the Merger (the basis for her §§ 11 and 10(b) claims) and on the open market (the basis for additional § 10(b) claims).

The Complaint asserted a continuing fraud based, *inter alia*, on the materially overstated financial statements issued by CUC and Cendant. Based in part on Cendant's disclosures on April 15, July 14, and August 28, 1998, and the Restatements of financial statements filed thereafter,

---

1. The district court segregated the claims of PRIDES purchasers into a separate action because it determined that respondents had more than immaterial investments in the common stock of one of the underwriters of the PRIDES offering, Merrill Lynch, which could have been a defendant in the PRIDES purchasers' § 11 claim. *Id.* The district court rejected all other applications for a carve-out.

the Complaint alleged the overstatements were intentionally made to ensure that the reported results met or exceeded analysts' expectations, thereby artificially inflating the market price of CUC and Cendant stock during the Class Period. *Id.* The same overstatements of CUC's financial statements during 1995, 1996 and the first three quarters of 1997 that provided the basis for the claim that defendants artificially inflated the price of CUC stock prior to the Merger also constituted the primary basis for the claim that the registration statement for the Merger was materially false and misleading.

Contemporaneously with filing the Complaint, Lead Plaintiff also moved (i) to certify the Action as a class action pursuant to Rules 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure, and (ii) for partial summary judgment on liability only on the plaintiffs' claim against Cendant under § 11. Various defendants stated their intent to move to dismiss the Complaint, which would have automatically stayed all pre-trial discovery. *See* PSLRA, 15 U.S.C. § 78u-4(b)(3)(B). However, Lead Plaintiff obtained Cendant's agreement to begin document discovery immediately in exchange for Lead Plaintiff's agreement to temporarily suspend its motion for partial summary judgment on liability. Absent this agreement, discovery would not have commenced for at least six months.

Lead Plaintiff also obtained Cendant's consent to class certification. The motion was opposed by defendant E&Y, however, and it was only after Lead Plaintiff filed a reply brief, refuting each of the arguments raised by E&Y, that E&Y withdrew its opposition. The district court granted the class motion by Order entered January 28, 1999.

Certain defendants answered the Complaint denying all liability, while others moved to dismiss. After a hearing on July 8, 1999, the district court denied all of the motions to dismiss, except the court granted E&Y's motion to dismiss claims by persons who purchased Cendant securities after April 15, 1998, the date Cendant announced that E&Y's auditors' reports could no longer be relied upon. *In re*

Cendant Corp. Litig., 60 F. Supp.2d 354 (D.N.J. 1999). The moving defendants' subsequent answers to the Complaint denied any wrongdoing and asserted numerous defenses.

On August 6, 1999, the district court approved a Notice of Pendency of Class Action that was mailed to class members on October 8, 1999, and a Summary Notice of Pendency of Class Action that was published on October 18, 19 and 20, 1999, in *The Wall Street Journal*, in *The New York Times* and on the *PR Newswire*. The Notice of Pendency described the Action, the defendants and the claims asserted, and informed class members of the December 27, 1999 deadline to exclude themselves from the Class. Over 260,000 Notices of Pendency were mailed out; only 234 class members, or less than 1/10th of 1% of the Class, chose to opt out.

D. Discovery

Before formal discovery commenced, Lead Counsel reviewed voluminous public filings, articles and analyst reports concerning CUC, HFS and Cendant; all of CUC's and Cendant's financial statements and restatements; and the report to the Cendant Audit Committee and all exhibits thereto. Lead Counsel investigated Cendant, the individual defendants, E&Y and the senior E&Y personnel on the CUC audits and reviews, and conducted interviews with many former employees of CUC, HFS and E&Y. Lead Counsel received and analyzed all of the documents that Cendant had provided for the Audit Committee's investigation. Expert forensic accountants were retained to assist Lead Counsel in their review of the Audit Committee report, all exhibits thereto, and all other accounting documents.

Once formal discovery started, Lead Counsel served document requests and interrogatories on all defendants and served document subpoenas on relevant non-parties. Among the hundreds of thousands of documents reviewed were additional Cendant records, E&Y's audit and quarterly review working papers, records of the individual defendants, and documents produced by various non-parties, including

HFS's financial advisor for the Merger and the Audit Committee investigators.

E. Settlement Negotiations

To prepare for settlement negotiations, Lead Counsel retained investment bankers, Lazard Frères & Co. LLC ("Lazard"), and Arthur S. Ainsberg, as financial consultants. Lazard analyzed the business and financial condition of Cendant, and advised Lead Plaintiff and Lead Counsel about the likely impact that potential settlements would have on Cendant.

Lead Counsel also worked with a damages expert, Forensic Economics, Inc., to gain a thorough understanding of the Class's damages. Forensic Economics performed extensive research concerning Cendant, CUC and HFS, and prepared various analyses of possible recoverable damages. Lead Counsel also obtained the damage analyses prepared by Cendant's damages expert, National Economic Research Associates ("NERA"), in which NERA analyzed and critiqued Forensic Economics' damages analyses.

Lead Counsel conducted hard-fought, arms' length settlement discussions with Cendant and the HFS Individual Defendants over a six-month period beginning June 1999, during which counsel for these defendants strongly disputed the analyses and conclusions of Lead Plaintiff's financial consultant, and raised sharp disagreements with plaintiffs' damages calculation and each of its components. Later during the summer of 1999, Lead Counsel commenced settlement discussions with E&Y, which similarly challenged Lead Plaintiff's damages theory and further maintained that E&Y's conduct did not cause any damage to the Class.

By December, Lead Plaintiff was successful in reaching the essential terms of agreements with Cendant and the HFS Individual Defendants, and with E&Y, which were announced on December 7 and 17, 1999, respectively. After several additional months of negotiating the terms

necessary to effectuate the agreements and formulating the plan of allocation, settlement stipulations were executed and filed with the district court.

F. The Settlements

The settlements were designed to resolve all of the Class's claims against all defendants in the Action.

1. The Cendant Settlement

The Cendant settlement includes three primary elements:

1. A cash payment by Cendant of $2,851,500,000 with interest accruing since August 20, 2000. There is no reversion to Cendant of the settlement amount.

2. Cendant and the HFS Individual Defendants pay 50% of any net recovery they obtain from E&Y on claims they are litigating against E&Y.

3. Cendant agreed to institute significant corporate governance improvements, including: constituting Cendant's Board of Directors with a majority of independent directors; constituting the Audit, Nominating and Compensation Committees of the Board entirely with independent directors; and other relief.

In exchange, class members released Cendant and all of the individual defendants (whether previously associated with HFS or CUC) from all claims that were or could have been filed in the Action.

2. The E&Y Settlement

In exchange for class members releasing E&Y from all claims that were or that could have been filed in the Action, E&Y paid $335,000,000 in cash. The entire settlement amount has been accruing interest since April 15, 2000 for the benefit of the Class.

G. The Plan of Allocation

Class members who suffered a loss from their purchases of Cendant or CUC publicly traded securities during the

Class Period, and who submitted a claim form with required documentation, will receive a distribution from the settlement fund, in accordance with the plan of allocation.

The plan was discussed extensively in the district court opinion approving the settlements and plan. Pet. App. 212a – 234a. As the court of appeals stated in its opinion affirming the settlements and plan:

> The record shows that the [district] court carefully considered the expert advice, and then chose to accept the plan submitted by the Lead Plaintiff's damages expert over the plan submitted by [another objector's] expert. This kind of decision is intensely fact-based, falling within the purview of the District Court's discretion. The District Court properly based its decision on evidence offered by the Lead Plaintiff, which provided more than a sufficient evidentiary basis for its decision. . . . We therefore find no abuse of the court's discretion in its decision to accept the Plan of Allocation.

Pet. App. 83a.

The plan provides that a "Loss Amount" will be calculated for each purchase or acquisition of a Cendant or CUC publicly-traded security. Particular Loss Amounts are based on the level of artificial inflation in the price of each CUC and Cendant publicly-traded security, as determined by Lead Plaintiff's damages expert.

In accordance with accepted methods of calculating damages for violations of § 10(b), the damages expert estimated the percentage of artificial inflation in the daily closing market prices for Cendant and CUC common stock and for publicly-traded notes that it could attribute to the alleged wrongdoing. It measured the percentage price decline associated with each particular disclosure, adjusted that price reaction to eliminate any effects attributable to general market or industry conditions, and then used standard statistical techniques to ensure that the price reaction was statistically significant. In this way, the expert

isolated the price effects caused by the fraud. *See generally* Pet. App. 212a – 234a.

By accumulating the total isolated market reaction attributable to each public disclosure, plaintiff's expert determined the reasonable amount of artificial inflation in the market price of CUC and Cendant common stock and in the price of publicly-traded notes, expressed as a percentage of each publicly-traded security's closing market price as of April 15, 1998. The expert allocated the total artificial inflation in each Cendant security as of April 15, 1998 back to each prior quarterly period. The expert then determined the reasonable amount of total artificial inflation for the periods from April 16, 1998 (the first day after Cendant's initial partial disclosure) through July 14, 1998 (the date of Cendant's next partial disclosure), and from July 15, 1998 through August 28, 1998 (the last day of the Class Period). The percentage of artificial inflation in the closing market price calculated for the two post-April 15, 1998 periods was then applied to the closing market prices for each day within those periods. *Id.*

The plan of allocation further recognizes the difference in claims under § 11 possessed by persons who acquired Cendant common stock in the Merger compared to claims under § 10(b) possessed by all Class members. For Class members who acquired shares in the Merger (and therefore have § 11 claims), the plan of allocation provides that Loss Amounts are the *greater* of either the § 10(b) damages described above, or as would be dictated by the statutory formula of § 11(e). *Id.*

As a general rule, the § 10(b) damages calculated under the plan of allocation are higher than the statutory damages under § 11(e). For instance, the plan of allocation provides Class members who acquired Cendant stock in the Merger and retained their stock until the end of the Class Period with a "Loss Amount," pursuant to the § 10(b) damages calculation, of $15.31 per share whereas their damages pursuant to § 11(e), based on the price of the stock at the time of the Merger versus the price on April 16, 1998, when

the first § 11 claim was filed, would be only $13.06 per share – $2.25 per share more than their § 11 damages. But, as a safeguard to Class members with § 11 claims, in the event that a Class member has a loss under § 11(e) that is greater than the amount calculated pursuant to the § 10(b) formula in the plan, the plan of allocation provides that *the greater damage amount is attributed to that claim.*

H. Fairness Hearing and District Court Approval

The district court granted preliminary approval to the settlements and plan of allocation on March 29, 2000. The court-approved Notice of Settlement of Class Action (the "Settlement Notice") was mailed to potential class members, and a Summary Notice of Settlement of Class Action was published in *The Wall Street Journal*, in *The New York Times* and on the *PR Newswire*. In all, more than 478,000 Settlement Notices were sent out.

The deadline for objections to the settlements and plan of allocation was May 31, 2000. Only three Class members objected to either of the settlements. One non-class member who had filed a derivative action on behalf of Cendant objected to the Cendant settlement. And petitioner Mark objected to the plan of allocation. Not one of the 1,700 institutional investors in this country that are members of the Class, and who acquired extremely large holdings of Cendant and CUC stock during the Class Period, including in the Merger, objected either to the settlements or to the plan of allocation. Pet. App. 163a.

The district court held a fairness hearing on June 28, 2000, at which all objectors and Lead Plaintiff were granted the opportunity to be heard. Petitioner Mark presented no evidence to support her contention that the plan of allocation was improper, and no competing plan.

On August 15, 2000, the district court entered two opinions and various judgments and orders approving the Cendant and E&Y settlements and the plan of allocation. In one opinion, the district court addressed and overruled the

objections of the derivative plaintiff. *In re Cendant Corp. Litig.*, 109 F. Supp.2d 273 (D.N.J. 2000). In the other, the district court addressed and overruled all other objections to the settlements and the plan. Pet. App. 153a.

I. The Court of Appeals' Affirmance of District Court Approval

On August 28, 2001, the court of appeals, per Becker, C.J., joined by Judges Sloviter and Ambro, affirmed the district court's approvals of the settlements and plan of allocation. The court considered the settlements and plan in accordance with well-established law in the Circuit and elsewhere, and rendered a detailed opinion rejecting each of the points raised by appellants. *See* Pet. App. 1a – 152a; *see also In re Cendant Corp. Litig.*, 264 F.3d 286 (3d Cir. 2001) (affirming rejection of derivative plaintiff's objections).

Summarizing petitioner's arguments and its conclusion that the district court acted well within its discretion in approving the plan of allocation, the court of appeals stated:

> One objector contends that the claims under § 11 of the Securities Act of 1933, which only a subset of the class possesses, are legally stronger than the other claims held by class members, i.e., claims under § 10(b) of the Securities Exchange Act of 1934. Based on this disparity, the objector argues that the § 11 claimants should receive a larger share of the settlement proceeds. We conclude, however, that the § 11 claims here are not necessarily legally stronger than the § 10(b) claims, and that, at any rate, the basis for measuring the different legal strengths of the claims involved is too speculative to support the objector's contention. We thus hold that the District Court did not abuse its discretion in approving a settlement allocation that treated all claims more or less equally.

Pet. App. 6a (emphasis added). The court continued:

> [T]here are several considerations that convince us that the District Court did not abuse its discretion in

approving the Plan of Allocation. First, the difference in the liability standards between § 11 and § 10(b) claims ultimately does not make a substantial difference in this case, as it is basically undisputed that Cendant's employees committed fraud, so the necessary scienter for the § 10(b) claims has been admitted. It is true that there is a possible issue of proportionate liability that arises with the § 10(b) claims, because Cendant has stated that it would raise the defense that the scienter of its employees cannot be attributed to Cendant itself. However, as we noted previously, *see supra* Part III.A.4 [Pet. App. 46a – 50a], based on the record before us we think that Cendant would have a very difficult time making out this defense.

Second, the real difficulty in the trial of this case would have been establishing damages, a process which both § 10(b) and § 11 claimants would have to undergo equally and which almost certainly would devolve into a "battle of the experts." Although § 11 claimants could at the outset calculate their damages rather simply (by subtracting the price of the stock at the time the lawsuit was brought from the amount that they paid for the stock, see 15 U.S.C. § 77k(e)), the defendant can counter this calculation by showing that any or all of this difference in stock price was caused by something other than the fraud, *see id.* Thus, on a § 11 claim there would still be a "battle of the damage experts;" the only difference between a § 11 and a § 10(b) damage determination in this case is that, on a § 11 claim, the defendant would bear the burden of disproving the plaintiff's straightforward subtraction calculation. . . .

Finally, it is also important to note that the § 10(b) damages available to the class members in this case are generally greater than the § 11 damages available, so that in this respect the § 10(b) claims are potentially stronger than the § 11 claims. . . . At all events and for all these reasons, we are chary of holding that the respective legal strengths of the § 10(b) and § 11 claims

> involved here should have been factored into the fairness of the settlement determination. This would be a speculative enterprise at best, and the differences in strength of these claims are not so great as to make the outcome of this process clear.

Pet. App. 73a – 75a (emphasis added).

The court of appeals further distinguished two other cases involving Cendant, *In re Cendant Corp. PRIDES Litig.*, 51 F. Supp.2d 537 (D.N.J. 1999), and *Yeager v. Cendant Corp.*, 109 F. Supp.2d 225 (D.N.J. 2000), cited by petitioner as "evidence" of her contention that there was a "conflict" that arose between Class members with § 11 claims and those without such claims:

> [T]he *PRIDES* settlement and the *Yeager* litigation are distinguishable. The *PRIDES* settlement involved a paper payout rather than a cash payout (i.e., the plaintiffs got new Cendant stock for their old stock), *see Cendant PRIDES*, 51 F.Supp.2d at 540, while the case at bar involves a cash payout. . . . Second, *PRIDES* was a "claims made" settlement, with unclaimed settlement funds reverting back to Cendant, *see id.* at 541; here all the settlement cash (and interest) will go to the Class. . . . [T]he "claims made" nature of the *PRIDES* settlement meant that Cendant could agree to a settlement in that case that gave a much higher percentage recovery to all potential class members, because it knew that it only had to pay out to those class members who actually made claims, which was certain to be a subset of the entire class. Not only does this mean that *PRIDES* is not "really" a settlement for 100% recovery (because less than 100% of the potential claimants will make a claim, thus lowering the amount Cendant must pay out), it also means that the settlement in this case is not "really" a settlement for 36% recovery (because less than 100% of the potential claimants will make a claim, thus raising the amount each claimant will receive). . . .

> As for *Yeager*, that case was not a class action (the plaintiff had opted out of this Class) and was for far less in damages, so any comparisons between *Yeager* and this case are flawed at best. Furthermore, as we note above, the district court partially denied Yeager summary judgment on his § 11 claims because there was a genuine issue of material fact as to the amount of damages.
>
> For the foregoing reasons, we reject Mark's arguments and conclude that the District Court did not abuse its discretion by approving a settlement that treated § 10(b) and § 11 claims more or less equally.

Pet. App. at 75a – 77a. Petitioner's request for panel rehearing with suggestion for rehearing *en banc* was denied. Pet. App. 287a.

Mark's petition to this Court followed.

ARGUMENT

THERE ARE NO SPECIAL OR IMPORTANT REASONS FOR GRANTING THE PETITION FOR A WRIT OF CERTIORARI

This case involves a highly fact-specific, record-dependent question that is not suitable for this Court's review. There is no direct circuit conflict or conflict with any of this Court's decisions.

The decision to approve a plan of allocation of settlement proceeds, like a decision to approve a proposed settlement of a class action, is left to the sound discretion of the district court. Under clear law in the Third Circuit and elsewhere, it will be reversed only "for a clear abuse of discretion." *In re Prudential Ins. Co. of America Sales Practices Litig.*, 148 F.3d 283, 299 (3d Cir. 1998), *cert. denied*, 525 U.S. 1114 (1999) (citing *Girsh v. Jepson*, 521 F.2d 153, 156 (3d Cir. 1975)); *In re Oracle Sec. Litig.*, No. C-90-0931-VRW, 1994 WL 502054 (N.D. Cal. June 18, 1994) (plan of allocation). On appellate review of a district court's exercise of that discretion,

> [g]reat weight is accorded [the] views [of the trial judge] because he is exposed to the litigants, and their strategies, positions and proofs. He is aware of the expense and possible legal bars to success.

Walsh v. Great Atl. & Pac. Tea Co., 726 F.2d 956, 965 (3d Cir. 1983) (quoting *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 34 (3d Cir. 1971)).

Based on the abuse of discretion standard, a reviewing court will not interfere with the district court's exercise of discretion "unless there is a definite and firm conviction that the court . . . committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." *Hanover Potato Prods. v. Shalala*, 989 F.2d 123, 127 (3d Cir.1993).

In the present case, petitioner points to no such abuse of discretion or even any reason for this Court to review the decision of the court of appeals finding that there was no abuse of discretion. Notably, petitioner did not propose – in all her papers to the district court, to the court of appeals, and to this Court – a different plan of allocation from the one proposed by Lead Plaintiff. Petitioner merely asserted that the plan of allocation was flawed, and sought to be appointed as a lead plaintiff, with her counsel as lead counsel, to "negotiate" a better deal for Class members with § 11 claims. Pet. App. 72a. Yet, as stated in *Walsh v. Great Atl. & Pac. Tea Co.*, 726 F.2d at 964, a court's "principal obligation is simply to ensure that the fund distribution is fair and reasonable as to all participants in the fund." The Third Circuit unanimously held, after reviewing the extensive factual record of this case, that petitioner's claim of unfair treatment was too "speculative" to be cognizable.

While petitioner argues here that the district court should have recognized that a "conflict" among Class members existed under *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997), she conceded in her brief to the court of appeals that: "The objection does not undo the settlement or require the defendants to pay more money. Plaintiff here simply seeks a reallocation of settlement funds from those

who do not have a Section 11 Claim to those who do, former HFS shareholders.[FN. 5]."[2]

Petitioner thus conceded below a vital distinction between *Amchem*, a case that involved a pre-packaged class settlement designed to release claims of persons with present injuries resulting from asbestos-exposure and those without any present injuries, and the case at bar – a securities class action in which the Class was certified as a litigation class, and all members of the Class shared common claims and suffered actual damages stemming from the defendants' admitted wrongful conduct.

I. The Third Circuit's Affirmance Of The Plan Of Allocation Does Not Conflict With Any Decision Of This Court Or Any Appeals Court, And Is Not Entitled To Review By This Court

Petitioner fails to cite a single case that required the plan of allocation to provide an enhanced recovery for Class members who had § 11 and § 10(b) claims over the recovery of Class members who had only § 10(b) claims. She further fails to address at all that the court of appeals appropriately applied well-settled law that a district court's approval of a plan of allocation may not be reversed unless the reviewing court determines that the district court abused its discretion in approving the plan.

Under Rule 23, approval of a plan for allocating settlement proceeds among class members is "governed by the same standards of review applicable to approval of the settlement as a whole: the plan must be fair, reasonable and adequate." *In re Oracle Sec. Litig.*, No. C-90-9031-VRW, 1994 WL 502054, at *1 (N.D. Cal. Jun. 18, 1994); *accord*

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2. Footnote 5 to Mark's Brief stated: "Should this Court reverse the District Court and reject the Plan of Allocation, it should also determine that plaintiff Ann Mark be appointed as a Lead Plaintiff on behalf of HFS Section 11 Claims and that the undersigned counsel be appointed as Lead Counsel on behalf of these claims in order to formulate and negotiate a new Plan of Allocation that adequately compensates the former HFS shareholders for their stronger Section 11 Claims."

Class Plaintiffs v. City of Seattle, 955 F.2d 1268, 1284-85 (9th Cir. 1992). "A plan of allocation that reimburses class members based on the extent of their injuries is generally reasonable." *In re Oracle*, 1994 WL 502054, at *1.

As the court of appeals found, the plan of allocation approved by the district court was reasonable. Whether one set of claims was "stronger" than another, as postulated by petitioner, was highly speculative in the circumstances of this case. But, one thing was certain: the damages recoverable under § 10(b) – which the plan of allocation made available to Class members with § 11 claims – generally exceeded the damages recoverable under § 11. Thus, the district court acted well within its discretion in approving a plan of allocation that treated Class members with both § 11 and § 10(b) claims equally with members who had only § 10(b) claims, by providing the former with the ability to recover for the greater damages generally available under § 10(b).

Not only has petitioner failed to cite a single case that supports her position that § 11 claims are entitled to enhanced recoveries over § 10(b) claims in securities fraud class actions generally, but even if such an enhanced recovery might be appropriate in the circumstances of another case, the district court and court of appeals both cited reasons why no such enhanced recovery was required in the circumstances of this case. The court of appeals made no grand pronouncement applicable to any other situation. It merely concluded:

> that the § 11 claims here are not necessarily legally stronger than the § 10(b) claims, and that, at any rate, the basis for measuring the different legal strengths of the claims involved is too speculative to support the objector's contention.

Pet. App. 6a (emphasis added).

Cendant's admissions that certain former senior executives of CUC (Cendant's predecessor) had intentionally engaged in a massive fraud that overstated the

company's financial statements in order to impact the price of the company's stock were tantamount to admissions of the company's liability under both § 11 and § 10(b). Pet. App. 49a – 50a. Given the company's admissions of willful misconduct, the company would likely have been jointly and severally liable for all damages found against defendants, not just for its proportionate liability, although that risk existed. *Id.* Thus, in general, while it may be that claims brought pursuant to § 11 are "stronger" in the abstract than claims brought pursuant to § 10(b), in the particular circumstances of the case at bar, such differences were not significant. There is simply no basis or reason to review the ruling of the court of appeals that applied well-settled law to the specific facts of this *sui generis* case.

Petitioner's attempt to compare the *Cendant* Class case to *Yeager* is without merit. Most importantly, this is a class action, while *Yeager* was an individual action with claimed § 11 damages of $15.85 million *(see* 109 F. Supp.2d at 228) – less than ⅛th of 1% of the Class's damages. This alone prevents comparison of *Yeager* to this Action. As the court of appeals found:

> As for *Yeager*, that case was not a class action (the plaintiff had opted out of this Class) and was for far less in damages, so any comparisons between *Yeager* and this case are flawed at best.

Pet. App. 77a (emphasis added).

Indeed, a portion of Yeager's motion for a damages award on his § 11 claim was denied, based on the defendant's contrary proof of damages.[3] In *Yeager*, the individual plaintiff sold all of the Cendant stock he acquired in the

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3. Petitioner's attempt to ridicule the court of appeals by stating that it misread the district court's summary judgment opinion in *Yeager* (Pet. at 28) is misguided. The court of appeals clearly recognized that while the district court granted summary judgment to Yeager on his § 11 claim against Cendant on liability, the district court denied Yeager's motion for summary judgment, even on his § 11 claim, to the extent that Cendant presented contrary evidence on damages.

Merger after the initial disclosure of wrongdoing on April 15, and therefore, was able to calculate, with certainty, his *prima facie* § 11(e) damages. Pet. App. 242a & 245a – 246a. But, even though Yeager was able to "fix" his *prima facie* damages, the district court still awarded Yeager a judgment of less than 75% of his asserted damages, based on the defendant's contrary damages evidence. *See id.* Thus, petitioner's claim that Class members with § 11 claims could have obtained 100% of their damages by summary judgment is demonstrably false. Indeed, Class members who retained their stock acquired in the Merger until the end of the Class Period were greatly benefited from being able to calculate their losses based on their § 10(b) rather than their § 11 claim, and as the court of appeals found, the informal discovery that Lead Plaintiff obtained in return for deferring the summary judgment motion "produced information relevant to determining the Class's damages, which was beneficial to both the § 11 and § 10(b) claims." Pet. App. 74a.

The *PRIDES* settlement, also cited by petitioner, is inapplicable as well for a number of reasons: (a) the Class's damages of the *Cendant* Class were 25 times those suffered by the *PRIDES* Class; (b) the recovery was ten times the amount of the *PRIDES* settlement; (c) the *PRIDES* settlement included no cash at all but, rather, additional newly created Cendant securities; (d) the *PRIDES* Settlement was a "claims made" settlement, with unclaimed PRIDES reverting to Cendant; and (e) the PRIDES class received no interest. Pet. App. 181a – 182a.

Citing these reasons, the district court, which presided over both class actions, held that the settlements in this Action "cannot be compared to the *PRIDES* settlement." *Id.* The court of appeals concurred in the district court's determination that the *PRIDES* case is inapplicable:

> The *PRIDES* settlement involved a paper payout rather than a cash payout (i.e., the plaintiffs got new Cendant stock for their old stock), *see Cendant PRIDES*, 51 F.Supp.2d at 540, while the case at bar involves a cash

> payout. Second, *PRIDES* was a "claims made" settlement, with unclaimed settlement funds reverting back to Cendant, see id. at 541; here all the settlement cash (and interest) will go to the Class. This point is important because it means that unmade claims in this Settlement will increase the percentage return for each class member, while unmade claims in the *PRIDES* settlement did not increase each class member's return but instead decreased the amount that Cendant had to pay out. . . .
>
> Thus, the "claims made" nature of the PRIDES settlement meant that Cendant could agree to a settlement in that case that gave a much higher percentage recovery to all potential class members, because it knew that it only had to pay out to those class members who actually made claims, which was certain to be a subset of the entire class.

Pet. App. 75a – 77a.

There is no legal authority that supports the petitioner's claim that the approved plan was unreasonable or unfair to any Class member. Indeed, throughout all the proceedings below, petitioner never proposed an alternative plan. But, even if she had, as the court of appeals concluded, it would have been a "speculative enterprise at best" to determine whether the respective legal strengths of the § 10(b) and § 11 claims "should have been factored into the fairness of the settlement determination." Pet. App. 75a.

For all these reasons, neither the district court's approval of the plan of allocation, nor the ruling of the court of appeals that the district court did not abuse its discretion in approving the plan, is suitable for review.

II. The Third Circuit's Ruling Does Not Violate Rule 23 Nor Does It Conflict With Any Decision Of This Court Or Any Court Of Appeals

The decisions of the courts below rejecting petitioner's contention that an irreconcilable "conflict" arose with respect to allocation of the settlement proceeds is correct

and does not conflict with any decision of this Court or of any other court of appeals. Petitioner cites no decision of any court holding that the Lead Plaintiff or the district court was required to establish a separate class or sub-class for holders of § 11 claims. To the contrary, certification of a single class was entirely appropriate under Rule 23, and is consistent with numerous cases that have certified classes that include investors with both § 11 and § 10(b) claims. Further, creating such a sub-class in *Cendant* would have been particularly senseless because the fraud in this case was admitted by the primary corporate defendant, and the misstatements that made the registration statement for the Merger false and misleading, thereby providing the basis for viable causes of action under both § 11 and § 10(b), also provided the basis for § 10(b) claims for purchasers of CUC and Cendant stock and other publicly traded securities on the open market.[4]

Lead Plaintiff/ respondents had no conflict that disabled them from proposing an allocation plan that distributed settlement proceeds to § 11 claimants *and* to § 10(b) claimants. Pet. App. 184a – 186a. "[T]he interests of [class representatives] do not have to be identical to the interests of every class member; it is enough that they 'share common objectives and legal or factual positions.' " *Petrovic v. Amoco*

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4. Petitioner's own purchases of Cendant stock show that creating a separate sub-class for § 11 claimants would have been folly. Petitioner purchased 240 shares in the Merger (in exchange for 100 shares of HFS stock) and 400 shares on the open market. Pet. App. 31a. She joined in the Complaint filed in December 1998 in which plaintiffs (a) asserted both § 11 and § 10(b) claims, and (b) sought a single class comprised of all purchasers of Cendant and CUC publicly traded securities. Indeed, Mark's purchases of stock in the Merger and on the open market placed her in the same alleged "conflict" position that she claims made the Lead Plaintiff inadequate to serve as the representative of the unitary Class for purposes of proposing a plan of allocation. Yet, in her Objection and appeal, Mark asked those courts "to appoint her lead plaintiff, and her counsel as lead counsel, for a subclass composed of the class members with § 11 claims," *see* Pet. App. 72a (emphasis added), thus revealing her true motive for alleging a "conflict" where no genuine conflict existed.

Oil Co., 200 F.3d 1140, 1148 (8th Cir. 1999) (quoting 7A Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, *Federal Practice and Procedure: Civil 2d* § 1769 at 367 (2d ed. 1986)).

The alleged "conflict" in this case was not an actual conflict. As stated in *Walsh v. Great Atl. & Pac.*, 726 F.2d at 964, in the context of an objector arguing that class counsel should not have represented all members of the class in formulating an allocation plan: "disagreements over the proper division of a settlement fund do not necessarily create conflicts of interest requiring separate representation. . . . The court was required to and did consider whether class counsel provided fair and adequate representation to the class as a whole. There was no abuse of discretion in refusing to remove class counsel."

Here, Lead Plaintiff prosecuted the Action, from beginning to end, on behalf of the entire Class. Lead Plaintiff filed a complaint that protected the rights of all Class members; sought and obtained certification of a Class; opposed motions to dismiss and motions to stay proceedings that would have impacted adversely each Class member; sought formal and informal discovery that benefited all Class members; and engaged in intensive negotiations that resulted in landmark recoveries for the Class – recoveries over four times greater than any other securities class action case. Moreover, the Lead Plaintiff group entities each had § 11 and § 10(b) claims, just as did petitioner, and none had any personal interest in structuring an allocation plan that advantaged the latter at the expense of the former.

In *Petrovic*, a class member argued that there was an inherent conflict when the class representative proposed an allocation plan that treated class members differently. However, even in that circumstance, the court of appeals held that no conflict arose that required separate representation of various Class members. 200 F.3d at 1145-48. The same is true here. As long as the Class shared common claims that predominated over individual issues, there was no requirement, as the courts below found, that the Class be

sub-divided in formulating a plan of allocation – a result that presents *no conflict* with any decision of this Court or any other court of appeals.

In re Prudential, 148 F.3d 283, is also on point. There, the court of appeals approved a class settlement and the certification of a single 8 million member class in spite of an objector's argument that the class plaintiffs could not adequately represent them and had claims that were not typical of all claims of class members. As the court stated:

> [t]he named plaintiffs, as well as the members of the proposed class, all have claims arising from the fraudulent scheme perpetrated by Prudential. That overarching scheme is the linchpin of the Second Amended Consolidated Complaint.... Consequently, the factual distinctions among and between the named plaintiffs and the 8 million putative class members do not defeat a finding of typicality.

Id. at 311.

Courts have long held that a single plaintiff may represent purchasers with different claims without creating any conflict requiring separate representation. *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 909 (9th Cir. 1975). Indeed, plaintiffs in securities class actions regularly represent class members with claims under the Securities Act (§§ 11 and 12(a)(2)) and those with claims under the Exchange Act (§ 10(b)). *E.g., In re Westinghouse Sec. Litig.*, 90 F.3d 696, 700, 701-02 (3d Cir. 1996) (upholding complaint for a single class that alleged claims under §§ 10(b), 11 & 12(a)(2)); *Eichenholtz v. Brennan*, 52 F.3d 478 (3d Cir. 1995) (affirming approval of settlement on behalf of class that alleged claims under §§ 10(b), 11 and 12(a)(2)); *accord Rodney v. KPMG Peat Marwick*, 143 F.3d 1140, 1143 (8th Cir. 1998); *Hartley v. Stamford Towers Limited Partnership*, 36 F.3d 1102 (9th Cir. 1994) (unpublished opinion at 1994 WL 463497); *In re Jiffy Lube Sec. Litig.*, 927 F.2d 155, 157 (4th Cir. 1991); *Dietrich v. Bauer*, 192 F.R.D. 119 (S.D.N.Y. 2000); *Danis v. USN Communications, Inc.*, 189 F.R.D. 391,

394-95, 398-99 (N.D. Ill. 1999); *Weinberger v. Thornton*, 114 F.R.D. 599, 603-04 (S.D. Cal. 1986).

Notwithstanding this long line of unbroken authority, petitioner asserts that *Amchem Prod., Inc. v. Windsor*, 521 U.S. 591 (1997), *aff'g, Georgine v. Amchem Prod., Inc.*, 83 F.3d 610 (3d Cir. 1996), effected a "sea change" and requires courts to provide for sub-classes, with separate representation, when different class members have different claims.[5] Petitioner misreads *Amchem*.

In *Amchem*, the court of appeals, per Becker, C.J., concluded that a single class was not appropriate where certain class members had claims that had accrued at the time, while others had only potential future claims. This Court, in line with the analysis of the court of appeals, further considered that certification of the class in *Amchem* was effectuated for *settlement purposes only*. Noting that "[n]o settlement class called to our attention is as sprawling as this one," 521 U.S. at 624, this Court affirmed the denial of the proposed class. The Court highlighted the myriad differences among class members, particularly between those who had manifested injury and those who were *currently* uninjured:

> Class members were exposed to different asbestos-containing products, for different amounts of time, in different ways, and over different periods. Some class members suffer no physical injury or have only

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5. Petitioner's assertion that a "conflict" exists is belied by her own briefing to the court of appeals. In her Reply Brief, at 6, when confronted with Lead Plaintiff's answering brief on the asserted "conflict" issue, Mark wrote: "Mark is objecting to the Plan of Allocation. Her arguments relating to Lead Plaintiffs' conflicts and inadequate representation of Section 11 claimants simply proposed an explanation of what occurred here. Even if the District Court had properly appointed an independent plaintiff and counsel specifically to represent Section 11 claimants and that representation resulted in the present Plan of Allocation, *it would still be objectionable*. . . It is the Plan of Allocation that Mark is objecting to, not all of the preliminary proceedings that caused the Plan of Allocation." (Emphasis in original).

> asymptomatic pleural changes, while others suffer from lung cancer, disabling asbestosis, or from mesothelioma.... Each has a different history of cigarette smoking, a factor that complicates the causation inquiry.
>
> The [exposure-only] plaintiffs especially share little in common, either with each other or with the presently injured class members. It is unclear whether they will contract asbestos-related disease and, if so, what disease each will suffer. They will also incur different medical expenses because their monitoring and treatment will depend on singular circumstances and individual medical histories.

Amchem, 521 U.S. 591 at 624. The Court thus affirmed the court of appeals' rejection of the pre-packaged class settlement, holding that the interests of the proposed class members were largely adverse to one another. *Id.* at 626.

There is no precedent for applying *Amchem* to this Action. Indeed, this Court distinguished the *Amchem* situation from a securities class action, stating: "[p]redominance is a test readily met in certain cases alleging consumer or securities fraud or violations of the antitrust laws." *Amchem*, 521 U.S. at 625. Moreover, Third Circuit Chief Judge Becker, the author of the decision in *Georgine v. Amchem*, certainly was aware of the reach, and limits, of this Court's *Amchem* decision, and concluded in the case below that there were overwhelming common issues shared by § 11 and § 10(b) claimants in this case. As the court noted, every § 11 claimant here *also* has a § 10(b) claim for the exchange of their shares, and the § 10(b) claim of such class members generally provides *greater damages* – which would necessarily have to be proven by expert testimony, and could not simply be assumed – than are available to those same Class members under their § 11 claims.[6]

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6. *See also Lazy Oil Co. v. Witco Corp.*, 166 F.3d 581, 588 (3d Cir. 1999) (post-*Amchem* decision ruling that there was no abuse of discretion in district court's denial of objectors' motion at settlement stage for

Another key difference, of course, is that the class in *Amchem* was certified by agreement of the parties as a *settlement* class. *Amchem*, 521 U.S. at 601-02 ("The class action thus instituted was not intended to be litigated. Rather, . . . the settling parties . . . presented to the District Court a complaint, an answer, a proposed settlement agreement, and a joint motion for conditional class certification."). While petitioner makes a half-hearted attempt to argue that the Class here should also be viewed as a settlement class (Pet. at 25-26), the court of appeals rejected this argument in dismissing another appeal:

> The Davidsons argue that the reaching of a settlement in effect made this class action a settlement class action, so that the notice requirements for a settlement class action set forth in *In re General Motors Corp. Pick-up Truck Fuel Tank Prod. Liab. Litig.*, 55 F.3d 768, 792 (3d Cir. 1995), apply here. We disagree.
>
> This was not a settlement class action but a previously certified class action that settled.

Pet. App. 79a – 80a (emphasis added). Further highlighting the differences between a litigated securities law class and the situation in *Amchem*, the Eighth Circuit court stated:

> The difficulties associated with settlements like those in *Amchem* and *Ortiz* – the possibility of "collusion between class counsel and the defendant . . . [and] the need for additional protections when the settlement is not negotiated by a court designated class representative," – are therefore not present here. . . . The district court still had the benefit of the parties' extensive trial preparation, and the definition of the mandatory class was the same as the definition of the class originally certified under Fed. R. Civ. P. 23(b)(3) (although, obviously, the mandatory class also included those

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certification of a sub-class, especially where claimed distinction that certain class members had suffered distinct and greater damages was found to be "unsupported by the facts of the case").

> who opted out of the class litigation with respect to compensatory relief).

Petrovic, 200 F.3d at 1146 (quoting *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1026 (9th Cir.1998)).

In this case, the district court certified the Class nearly one year before the settlements were reached. The Class was certified during litigation; there was a clear common course of conduct that led to common issues of fact and law that predominated over any individual issues; the claims of the Lead Plaintiff were typical of the claims of absent class members; and the interests of the Lead Plaintiff were not adverse to the interests of any absent class member. *See* Pet. App. 185a – 186a. Thus, the problems with settlement classes or future injured claimants present in *Amchem* are inapplicable.

In short, the judgment below does not conflict with any decision by this Court or with any decisions in other courts of appeals.

CONCLUSION

For all of the foregoing reasons, the petition for writ of certiorari should be denied.

Dated: February 6, 2002

Respectfully submitted,

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Supreme Court, U.S.
FILED
FEB 22 2002
CLERK

(4)

No. 01-997

IN THE

Supreme Court of the United States

ANN MARK,

Petitioner,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, NEW YORK STATE RETIREMENT FUND and NEW YORK CITY PENSION FUNDS,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF

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COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

14 pp

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SUMMARY OF ARGUMENT

By only the fourth word on the first page of Respondents' Brief[1] (i.e., the Counter-Statement of the Question Presented) Lead Plaintiffs/respondents ("respondents") make it abundantly clear that they still "don't get it." In characterizing this action as a "securities *fraud* class action" on the first page of their brief (emphasis added) and repeatedly throughout the brief, respondents only emphasize the conflict and difficulty of adequately representing the interests of one group of class members with only *fraud* claims and another group of class members with *strict liability* claims.

This case presents the Court with the opportunity to apply its teaching with respect to the obligations of lower courts under Rule 23 of the Federal Rules of Civil Procedure to insure that the interests of class members with diverse claims are protected in federal securities class actions. It presents a set of facts that in the end, exposes the cost to class members, with distinct securities claims, of a district court's failure either at the outset or at the conclusion of an action to acknowledge and establish "structural assurance of fair and adequate representation for the diverse groups and individuals affected." *Amchem Prods. v. Windsor*, 521 U.S. 591, 627 (1997).

The gravamen of the court of appeals' affirmance of the plan of allocation (the "Plan") — that "the basis for measuring the different legal strengths of the claims involved is too speculative" (Pet. App. 6a)[2] — is flatly contradicted by the factual record below. This unusually *fact-rich* environment demonstrates beyond doubt that class members with strict liability claims under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k (the "Section 11 Claimants") should have received a materially greater amount of the settlement funds than they did under the approved allocation. The extensive

1. Further references to the Brief of Respondents in Opposition to Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit are cited as "Resp. Br., at __"

2. References to the Appendix are cited as "Pet. App. __."

factual record here is a virtue, not the vice euphemistically described by respondents as "highly fact intensive and case-specific" (Resp. Br., at 1) or "highly fact-specific, record dependent." (Resp. Br., at 15). To the contrary, the facts here serve to highlight the inadequacies to Section 11 Claimants resulting from a conflicted lead plaintiff in a securities class action. At least three simple facts make it clear that the Plan[3] should have provided greater compensation for Section 11 Claimants as compared to Section 10(b) Claimants, class members with only fraud claims under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).

First, class members with Section 11 claims could obtain immediate summary judgment on liability *and* between 75%, *Yeager v. Cendant Corp.*, Pet. App. 241a-263a (*"YEAGER"*) to 100%, *In re Cendant Corp. PRIDES Litig.*, 51 F. Supp. 2d 537 (D. N.J. 1999), *aff'd in part, rev'd in part*, 235 F.3d 1786 (3d Cir. 2000), *cert. denied*, 122 S. Ct. 202 (2001) (*"PRIDES"*) of claimed damages. The *PRIDES* action, the *YEAGER* action, and the underlying legal and factual record show that fact. Second, class members with only Section 10(b) claims were not entitled to immediate relief on any issue and, in the absence of a settlement, looked forward to years of discovery, trial, and the risk of proportionate liability. Third, class members with Section 11 claims who had separate counsel, i.e. the *PRIDES* class and the *YEAGER* plaintiffs, did in fact, achieve substantially greater monetary results than did those represented by respondents. And the *PRIDES* class and the *YEAGER* plaintiffs were not required to defer the assertion of *their* rights

3. Respondents have regularly complained (Resp. Br. at 16) that petitioner never proposed an alternative plan of allocation as if failing to do so constituted some flaw in her argument. Unlike respondents, petitioner has never presumed to be able to unilaterally impose a plan that adversely impacts interests that conflict with her own. And if it has not been obvious in petitioner's papers in the district court, the court of appeals and this Court, certainly her preferred plan would provide for a 100% recovery of damages to Section 11 Claimants with the remainder to Section 10(b) Claimants.

for several years while Section 10(b) claims were pursued by others. The conclusion of the court of appeals that these types of differences were not significant is clearly wrong. And the comparisons being made by respondents and the courts below between the relative sizes of the settlement in the *PRIDES* action ($341.5 million) and claim in the *YEAGER* action ($15.85 million), as compared to the settlement in the Cendant action ($3.2 billion), as an excuse for why the normal rules of analysis should not apply, seem to suggest that typical conflicts of interest and the entitlement of absent class members to due process should be primarily determined by how much money is at stake, an idea that is antithetical to the concept of due process itself.

The Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4, can cause district courts, lead plaintiffs and their counsel, to become trapped in an untenable Catch-22. The PSLRA strongly encourages district courts to appoint the single party with the largest financial loss as lead plaintiff. Thus, there is an inherent desire for the district court to deal with one class and one counsel. This approach, no matter how well-intentioned, means that once the litigation is underway and progresses to a proposed settlement, the lead plaintiff and its counsel cannot even consider a plan of allocation that provided for varying payments to different groups of class members. To do so would bring to light that a conflict likely existed from the outset of the litigation. Accordingly, the lead plaintiff and its counsel are incentivized to deny conflicts ever existed and to deny at least one distinct group of absent class members, with stronger claims than others, a fair plan of allocation.[4]

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4. The need for this Court to address these allocation and conflicts issues at this time is also further demonstrated by the recent shareholder class action litigations spawned by alleged massive accounting frauds occurring over several years and touching different classes of investors and employees. Such alleged frauds might involve a wide array of different groups of defendants, including officers and directors, accountants and outside attorneys, and can involve conflicting and (Cont'd)

ARGUMENT

I. Respondents' Focus On The Court Of Appeals Analysis Of The Differences Between Section 11 And 10(b) Claims Is Misplaced

At the outset, the court of appeals analysis as to the differences between Section 11 and Section 10(b) claims, referred to and cited by respondents (Resp. Br., at 12-14), was flawed because it ignored or disregarded the most critical and obvious distinction between the two claims in the instant litigation, i.e. that Section 11 Claimants could obtain immediate summary judgment on liability and 75% of damages and Section 10(b) Claimants could not obtain summary judgment on anything. This distinction is not "too speculative" to measure. Cendant conceded Section 11 liability and 75% of claimed damages in the *YEAGER* action before the same district court that subsequently approved of the Cendant settlement. Thus, the district court knew, prior to its approval of the settlement and the Plan, that Section 11 liability and 75% of claimed damages was an absolute certainty.

First, the court of appeals mistakenly concluded that the difference in liability standards between Sections 11 and 10(b) "ultimately does not make a substantial difference in this case" (Pet. App. 73a) because Cendant's employees admitted fraud, so scienter for the Section 10(b) claims was admitted. The court of appeals even considered the risk of proportionate liability but dismissed it as too difficult for Cendant to assert as a defense. In coming to these erroneous conclusions, however, the court of appeals never focused on the fact that (i) Section 11 claims were entitled to immediate summary judgment on liability and for at least 75% of damages and Section 10(b) claims were not,

(Cont'd)
disparate claims. Despite the extended period over which these frauds occurred, the disparate interests of investors, the multiple defendants and the overall complexity of the litigation, courts often appoint a single lead plaintiff and a single lead counsel. This action provides this Court an opportunity to guide courts in choosing class representation and insuring an adequate plan of allocation.

and (ii) even though it was clear that Cendant employees committed fraud, (given the amount of finger pointing and denial among Cendant employees), the conclusion of the court of appeals that proving scienter entirely against Cendant was a foregone conclusion is not so clear.

Second, the court of appeals erroneously assumed that both Section 11 and Section 10(b) Claimants would have an equally difficult time in establishing damages. Pet. App. 74a. Here again, the court of appeals never considered the fact that (i) Section 11 claims were entitled to immediate summary judgment on liability and for at least 75% of claimed damages and Section 10(b) claims were not, and (ii) prosecution of the Section 11 damages claims did not require any discovery from defendants (other than their expert) and could have proceeded immediately to trial. On the other hand, establishing liability on the Section 10(b) claims would have taken years before the damage claims could have even been addressed.[5]

Finally, the court of appeals argument that Section 10(b) aggregate damages are generally greater than Section 11 aggregate damages and that this factor somehow makes Section 10(b) claims "potentially stronger" is also misplaced. Pet. App. 75a. The Section 10(b) damages that respondents calculated, $15.31 per share, were only 17% per share greater than the Section 11 damages calculated by respondents, or $13.06 per share. At the time that the lower court approved the Plan, Section 11 class members were looking at a 36% recovery

5. In its discussion of the difficulty of establishing damages cited by respondents' (Resp. Br. at. 20), the court of appeals stated that: "the informal discovery that Lead Plaintiff obtained in return for deferring the summary judgment motion produced information relevant to determining the Class's damages, which was beneficial to both the § 11 and § 10(b) claims." (Pet. App. 74a). There was no support in the record for this statement and there is otherwise no basis to believe that Cendant would have had any information relevant to Section 11 damages claims that was not publicly available. This comment by the court of appeals was sheer speculation and simply designed to explain away what was otherwise direct incontrovertible evidence of a sell out of the Section 11 claims by the respondents.

figure as compared to at least a 100% recovery in the *PRIDES* settlement and 75% recovery in the *YEAGER* action.

Even if it was relevant to the Court's analysis (which it is not), a potential 67% payout in hindsight, i.e. $10.25 per share, to Cendant class members resulting from the submission of fewer claims (before awarding legal fees and expenses) is still a far cry from the full recovery in the *PRIDES* action.[6] And 100% of the Section 11 per share damages, i.e. $13.06, is greater by more than 27%, than the $10.25 per share Section 10(b) recovery in the Cendant action.

Furthermore, simply because proving damages for Section 11 claims and Section 10(b) claims may arguably be equally complex, this fact, standing alone, is not compelling justification for ignoring the other vast distinctions between Sections 11 and 10(b) claims. Here again, the court of appeals never focused on the fact that (i) Section 11 claims were entitled to immediate summary judgment on liability and for at least 75% of damages and Section 10(b) claims were not, and (ii) prosecution of the Section 11 damages claims did not require any discovery from defendants (other than their expert) and could have proceeded immediately to trial.

II. The Court of Appeals Bases for Distinguishing the *PRIDES* and *YEAGER* Actions are Erroneous

A. The *PRIDES* Action

The court of appeals attempt to distinguish the *PRIDES* settlement, which in fact provided all class members with a nearly 100% cash equivalent recovery of damages, from the Cendant settlement, is flawed. Pet. App. 75a-77a. At the outset, it completely ignored and flatly contradicted the district court's holding in approving the *PRIDES* settlement that: "The class is completely made whole by such compensation."

The court of appeals, using 20-20 hindsight, observed in connection with the "paper payout" in the *PRIDES* settlement that:

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6. It is axiomatic that assessment of the fairness of an allocation plan should be at the time of adoption, not in hindsight.

> There was about a nine-month delay between the settlement approval and the date when the class members could sell their new shares in the market, and much could have happened to Cendant and its stock during that interim that could have affected the amount of return that the *PRIDES* plaintiffs received. Thus, the *PRIDES* "paper for paper" exchange involved a sizeable risk, at the time the settlement was entered into, of a payout substantially less than 100% of the class's damages.

Footnote 29 at Pet. App. 76a.

First, the *PRIDES* settlement (which provided *PRIDES* class members with additional securities) was initially valued at 110% more than the high end of the range of likely recovery for the Section 11 claims, i.e. 300% more than the 36% recovery provided for Cendant class members at the time the Cendant settlement was approved. As the *PRIDES* class notice stated:

> The potential recovery by the Class in respect of their Securities Act of 1933 claims has been estimated by experts retained by lead counsel for the Class to fall within a range of $268,125,000 to $313,950,000 or $9.19 to $10.77 per *PRIDES*. In lead counsel's view, the proposed settlement payment, based on the aggregate theoretical value of the Rights (approximately $341.5 million), thus exceeds the likely recovery by the Class in respect of its Securities Act of 1933 claims that extended litigation could yield if fully successful. In lead counsel's view, this premium recognizes that the Rights may trade in the market at a price below their theoretical value.

(*PRIDES* Settlement Notice, page 1). Accordingly, the risk that the securities might be worth less at the time that they could be sold by class members was already factored into the settlement.[7]

7. Of course, it almost goes without saying that the value of the securities issued in settlement could also have *increased*.

Second, respondents and the lower courts also pointed out that because *PRIDES* was a "claims made" settlement it did not compare favorably to the Cendant settlement (Resp. Br. at 21) (Pet. App. 75a-77a). However, a 100% cash equivalent recovery in a securities class action, after the payment of attorneys fees and expenses, even with funds reverting to defendants, is still a 100% cash equivalent recovery. *PRIDES* was not some lightly contested nuisance value settlement. And paper or not, the cash proposed to be paid to the Section 11 Claimants in the Cendant action still does not come close to the recovery achieved in the *PRIDES* action. Accordingly, the court of appeals analysis that the *PRIDES* 100% recovery was not really a 100% recovery seems like the court of appeals was just trying too hard to distinguish the *PRIDES* settlement.

Lastly, the admission of the court of appeals that "much could have happened to Cendant and its stock during that interim" and that there was a "sizeable risk" (footnote 29 at Pet. App. 76a) of a lower payout with the passage of time is a risk factor that could have adversely affected Section 11 Claimants in the Cendant action. In fact, "much could have happened" to the ability of the Section 11 Claimants to recover any damages. Cendant could have gone bankrupt while the Section 10(b) Claimants took years to prosecute their claims, and the Section 11 Claimants would have recovered nothing. The Section 11 Claimants, had they been represented by a separate lead plaintiff and lead counsel, could have obtained immediate summary judgment on liability and for the vast majority of damages, at the expense of the Section 10(b) Claimants. To require Section 11 Claimants to wait months or years while the Section 10(b) claims required extensive document and deposition discovery, clearly demonstrates (i) the egregious conflicts below, (ii) why the Section 11 claims were so much more valuable than the Section 10(b) claims, and (iii) why the Plan should have provided for an enhanced recovery for the Section 11 claims.

B. The *YEAGER* Action

The court of appeals' bases for distinguishing *YEAGER* were simply wrong. The fact that *YEAGER* was not a class action is irrelevant. The only amendments to the Exchange Act by the PSLRA that are not applicable to private actions are the subsections regarding the appointment of lead plaintiff. 15 U.S.C. § 78u-4(a); 15 U.S.C. § 77z-1(a). All other amendments, e.g., enhanced pleading requirements, the proof of loss causation, etc., are applicable to individual claimants under both the Exchange Act and the Securities Act.[8]

In addition, although the district court did not grant the *Yeagers'* damages claim in its entirety, it did grant approximately 75% of the damages as undisputed by Cendant. Moreover, petitioner has also learned that the district court's docket reflects that in November, 2001, the *YEAGER* action was dismissed with prejudice. Petitioner also learned that the dismissal was pursuant to a confidential settlement agreement. While we cannot be certain of the amount, it is patently clear that additional material consideration must have passed from Cendant to the Yeager plaintiffs to induce them to dismiss their action with prejudice. These facts further demonstrate that the immediate settlement value of the Section 11 claims materially exceeded the amount provided by the Plan.

III. Respondents' Authority Regarding The Representation Of Multiple Claims Is Inapplicable

Aside from the fact that the court of appeals failed to cite a single authority against petitioner in affirming the district court's denial of petitioner's objection, respondents themselves fail to cite a single authority on point contrary to petitioner's legal and factual arguments. Moreover, a closer examination of this Court's *Amchem* decision, which originated in the Third Circuit, demonstrates that *Amchem* is more similar to the issues here than recognized below. None of the other case law cited by

8. Further, the amount of damages sought by the Yeagers, $15.8 million, and the amount actually awarded on the motion for summary judgment, $11.6 million, involved amounts that are larger than what is recovered in many class actions.

respondents (Resp. Br. at. 24-25) involved the unusually strong and extensive set of facts that exist here or any facts for that matter that remotely resemble the litigation here. Accordingly, none of the case law cited by respondents is any impediment to this Court's grant of certiorari and reversal of the court of appeals.

Putting aside respondents' attempts to limit the applicability of *Amchem* to pre-packaged class action settlements, there is a striking similarity between the Section 11 and Section 10(b) Claimants in the instant litigation and the currently-injured claimants and exposure only or future claimants in *Amchem*. Like the currently-injured claimants in *Amchem*, who had a present injury and were immediately entitled to sue for damages, the Section 11 Claimants were entitled to immediate summary judgment on liability and at least 75% of their damages. And like the future claimants in *Amchem* who were not entitled to immediate relief but were possibly or likely to be entitled to such relief in the future, the Section 10(b) Claimants similarly, were not entitled to immediate relief and would likely have to wait through years of extensive discovery, trial and the risk of proportionate liability.

Moreover, the facts here make an even stronger argument that the interests of the Section 11 Claimants as compared to the interests and the Section 10(b) Claimants are even more disparate than the interests of the currently-injured and futures claimants in *Amchem*. Whereas the Section 11 Claimants here were immediately entitled to summary judgment and damages, the currently-injured claimants in *Amchem* had no immediate or even subsequent absolute right to anything. And like the futures claimants in *Amchem*, the Section 10(b) Claimants, in the absence of a quick settlement, were looking at several years of litigation and several significant risk factors.

CONCLUSION

The Court should grant the Petition for Certiorari.

Respectfully submitted,

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